

Supplement dated March 6, 1997

to the

Official Statement dated February 27, 1997

relating to the

\$250,000,000

PUBLIC FACILITIES FINANCING AUTHORITY
OF THE CITY OF SAN DIEGO

SEWER REVENUE BONDS, SERIES 1997A AND SERIES 1997B

(Payable Solely From Installment Payment Secured By Wastewater System Net Revenues)

Page 3 of the above-referenced Official Statement, under the subheading "Series 1997 Bonds," incorrectly states that the payment of interest on the Series 1997 Bonds commences on November 15, 1997. In fact, the payment of interest on the Series 1997 Bonds commences on May 15, 1997.

In addition, the definition of "**Interest Payment Date**" on page C-7 of the Official Statement is corrected as follows: "**Interest Payment Date**" means each May 15 and November 15.

NEW ISSUES-BOOK-ENTRY ONLY

In the opinion of Orrick, Herrington & Sutcliffe LLP, Los Angeles, California and Lofton, De Lancie & Nelson, San Francisco, California, Co-Bond Counsel, based upon an analysis of existing laws, regulations, rulings and court decisions and assuming, among other matters, compliance with certain covenants, interest on the Series 1997 Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986 and is exempt from State of California personal income taxes. In the further opinion of Co-Bond Counsel, interest on the Series 1997 Bonds is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, although Co-Bond Counsel observe that such interest is included in adjusted current earnings in calculating corporate alternative minimum taxable income. Co-Bond Counsel express no opinion regarding any other tax consequences related to the ownership or disposition of, or the accrual or receipt of interest on, the Series 1997 Bonds. See "TAX MATTERS."

\$250,000,000

PUBLIC FACILITIES FINANCING AUTHORITY OF THE CITY OF SAN DIEGO

SEWER REVENUE BONDS, SERIES 1997A AND SERIES 1997B (Payable Solely From Installment Payments Secured By Wastewater System Net Revenues)

Dated: February 1, 1997

Due: May 15, as shown below

The Series 1997A Bonds and the Series 1997B Bonds (collectively, the "Series 1997 Bonds") are issuable by the Public Facilities Financing Authority of the City of San Diego (the "Authority") as fully registered bonds and when initially issued will be registered in the name of Cede & Co., as nominee of The Depository Trust Company, New York, New York ("DTC"). Purchases of the Series 1997 Bonds will be made in book-entry form only, in denominations of \$5,000 or any integral multiple thereof, through brokers and dealers who are, or who act through, DTC Participants. Beneficial Owners of the Series 1997 Bonds will not be entitled to receive physical delivery of bond certificates so long as DTC or a successor securities depository acts as the securities depository with respect to the Series 1997 Bonds. So long as DTC or its nominee is the registered owner of the Series 1997 Bonds, reference herein to Bondholders are registered owners shall mean Cede & Co., as aforesaid, and payments of principal of and interest on the Series 1997 Bonds will be made directly to DTC by State Street Bank and Trust Company of California, N.A., as Trustee. Disbursement of such payments to DTC Participants is the responsibility of DTC and disbursement of such payments to the Beneficial Owners is the responsibility of DTC Participants. See "DESCRIPTION OF THE SERIES 1997 BONDS — Book-Entry-Only System."

Proceeds of the Series 1997A Bonds are to be applied to (i) pay design, engineering, land acquisition and construction costs of certain capital improvements to the Metropolitan System of the City of San Diego (the "City"), (ii) to fund a portion of the debt service reserve fund securing the Series 1997 Bonds and the Outstanding Parity Bonds (defined below) and (iii) to pay certain costs of issuance. So long as certain conditions are met, the City has the right to transfer the Metropolitan System facilities to a successor entity. Upon such transfer, the City's obligation to make Installment Payments relating to the Metropolitan System will be assumed by such successor entity and the City will no longer be responsible for such obligations. See "POSSIBLE TRANSFER OF OWNERSHIP OF METROPOLITAN SYSTEM."

Proceeds of the Series 1997B Bonds are to be applied to (i) pay design, engineering, land acquisition and construction costs of certain capital improvements to the Municipal System of the City, (ii) to fund a portion of the debt service reserve fund securing the Series 1997 Bonds and the Outstanding Parity Bonds and (iii) to pay certain costs of issuance.

The payment of principal of and interest on the Series 1997 Bonds when due will be insured by a municipal bond insurance policy to be issued simultaneously with the delivery of the Series 1997 Bonds by Financial Guaranty Insurance Company. See "SECURITY FOR THE SERIES 1997 BONDS — Bond Insurance" and "APPENDIX F — SPECIMEN MUNICIPAL BOND INSURANCE POLICY."



FGIC is a registered service mark used by Financial Guaranty Insurance Company, a private company not affiliated with any U.S. Government agency.

The Series 1997 Bonds are special, limited obligations of the Authority payable solely from and secured by Installment Payments to be made by the City to the Authority from Net System Revenues pledged and assigned pursuant to a Master Installment Purchase Agreement, as amended and supplemented by the 1993-1 Supplement, the 1995-1 Supplement and the 1997-1 Supplement to the Master Installment Purchase Agreement, each between the Authority and the City. The Series 1997 Bonds are issued on a parity with the Authority's Sewer Revenue Bonds, Series 1995 and Series 1993 (collectively, the "Outstanding Parity Bonds").

The obligation of the City to make Installment Payments does not constitute an obligation of the City for which the City is obligated to levy or pledge any form of taxation or for which the City has levied or pledged any form of taxation. Neither the pledge made by the Authority, nor the obligation of the City to make Installment Payments, creates a legal or equitable pledge, charge, lien or encumbrance upon any of the City's property, or upon its income, receipts or revenues other than Net System Revenues. The Authority has no taxing power.

The Series 1997 Bonds are subject to optional and mandatory redemption prior to maturity as described herein.

This cover page contains certain information for general reference only. It is not a summary of the issue. Investors are advised to read the entire Official Statement to obtain information essential to the making of an informed decision.

The Series 1997 Bonds will be offered when, as and if issued and received by the Underwriters, subject to the approval of validity by Orrick, Herrington & Sutcliffe LLP, Los Angeles, California and Lofton, De Lancie & Nelson, San Francisco, California, Co-Bond Counsel, and to certain other conditions. Certain legal matters in connection with the Series 1997 Bonds will be passed upon by Curls, Brown & Roushon, Los Angeles, California, Underwriters' Counsel, Casey Gwinn, Esq., City Attorney of the City of San Diego and General Counsel to the Authority and Orrick, Herrington & Sutcliffe LLP, Los Angeles, California, Disclosure Counsel. It is expected that the Series 1997 Bonds will be available for delivery through DTC in New York, New York on or about March 6, 1997.

SMITH BARNEY INC.

PAINWEBBER INCORPORATED

BANCAMERICA SECURITIES, INC.

ARTEMIS CAPITAL GROUP, INC.

February 26, 1997

\$183,000,000 SERIES 1997A BONDS

MATURITIES, AMOUNTS, INTEREST RATES AND YIELDS

\$90,095,000 Serial Bonds

<u>Maturity May 15</u>	<u>Amount</u>	<u>Interest Rate</u>	<u>Yield</u>	<u>Maturity May 15</u>	<u>Amount</u>	<u>Interest Rate</u>	<u>Yield</u>
1998	\$2,860,000	3.700%	3.700%	2008	\$4,385,000	5.000%	5.000%
1999	2,965,000	3.900	3.900	2009	4,605,000	5.000	5.100
2000	3,080,000	4.100	4.100	2010	4,835,000	5.100	5.200
2001	3,205,000	4.200	4.200	2011	5,080,000	5.200	5.250
2002	3,340,000	4.350	4.350	2012	5,345,000	5.250	5.300
2003	3,485,000	4.500	4.500	2013	5,625,000	5.250	5.350
2004	3,640,000	4.600	4.600	2014	5,920,000	5.375	5.400
2005	3,810,000	4.700	4.700	2015	6,240,000	5.375	5.450
2006	3,990,000	4.800	4.800	2016	6,575,000	5.375	5.500
2007	4,180,000	4.900	4.900	2017	6,930,000	5.375	5.500

\$40,540,000 5.250% Term Bonds Due May 15, 2022 — @ 5.570%

\$52,365,000 5.250% Term Bonds Due May 15, 2027 — @ 5.610%

(Accrued interest to be added)

\$67,000,000 SERIES 1997B BONDS

MATURITIES, AMOUNTS, INTEREST RATES AND YIELDS

\$32,985,000 Serial Bonds

<u>Maturity May 15</u>	<u>Amount</u>	<u>Interest Rate</u>	<u>Yield</u>	<u>Maturity May 15</u>	<u>Amount</u>	<u>Interest Rate</u>	<u>Yield</u>
1998	\$1,045,000	3.700%	3.700%	2008	\$1,605,000	5.000%	5.000%
1999	1,085,000	3.900	3.900	2009	1,685,000	5.000	5.100
2000	1,130,000	4.100	4.100	2010	1,770,000	5.100	5.200
2001	1,175,000	4.200	4.200	2011	1,860,000	5.200	5.250
2002	1,225,000	4.350	4.350	2012	1,955,000	5.250	5.300
2003	1,275,000	4.500	4.500	2013	2,060,000	5.250	5.350
2004	1,335,000	4.600	4.600	2014	2,170,000	5.375	5.400
2005	1,395,000	4.700	4.700	2015	2,285,000	5.375	5.450
2006	1,460,000	4.800	4.800	2016	2,405,000	5.375	5.500
2007	1,530,000	4.900	4.900	2017	2,535,000	5.375	5.500

\$14,845,000 5.250% Term Bonds Due May 15, 2022 — @ 5.570%

\$19,170,000 5.250% Term Bonds Due May 15, 2027 — @ 5.610%

(Accrued interest to be added)

No broker, dealer, salespersons or other persons has been authorized by the City of San Diego, the Public Facilities Financing Authority of the City of San Diego or the Underwriters to give any information or to make any representations other than those contained herein and, if given or made, such other information or representation must not be relied upon as having been authorized by the City of San Diego, the Public Facilities Financing Authority of the City of San Diego or the Underwriters. Neither the delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the City of San Diego or the Public Facilities Financing Authority of the City of San Diego. This Official Statement does not constitute an offer to sell or the solicitation of an offer to buy, nor shall there be any sale of the Series 1997 Bonds by a person in any jurisdiction in which it is unlawful for such person to make such offer, solicitation or sale.

This Official Statement is not to be construed as a contract with the purchasers of the Series 1997 Bonds. Statements contained in this Official Statement which involve estimates, forecasts or matters of opinion, whether or not expressly so described herein, are intended solely as such and are not to be construed as representations of facts.

The information set forth in this Official Statement has been obtained from official sources and other sources which are believed to be reliable, but it is not guaranteed as to accuracy or completeness, and is not to be construed as a representation by the Underwriters. The information and expressions of opinion herein are subject to change without notice, and neither the delivery of this Official Statement nor any sale made hereunder shall under any circumstances create any implication that there has been no change in the affairs of the City of San Diego, the Public Facilities Financing Authority of the City of San Diego or the Wastewater System since the date hereof. This Official Statement is submitted in connection with the sale of the Series 1997 Bonds referred to herein and may not be reproduced or used, in whole or in part, for any other purpose.

The summaries and references to the Indenture, the Installment Purchase Agreement, the Continuing Disclosure Agreement, the City Charter and to other statutes and documents referred to herein do not purport to be comprehensive or definitive and are qualified in their entirety by reference to each such document and statute. This Official Statement including any amendment or supplement hereto is intended to be deposited with one or more depositories. The Series 1997 Bonds have not been registered under the Securities Act of 1933, as amended, in reliance upon an exemption from the registration requirements contained in such Act.

IN CONNECTION WITH THIS OFFERING OF THE SERIES 1997 BONDS, THE UNDERWRITERS MAY OVER-ALLOT OR EFFECT TRANSACTIONS THAT STABILIZE OR MAINTAIN THE MARKET PRICE OF SUCH BONDS AT A LEVEL ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

CITY OF SAN DIEGO

CITY COUNCIL

Susan Golding, *Mayor*

Harry Mathis
Byron Wear
Christine Kehoe
George Stevens

Barbara Warden
Valerie Stallings
Judy McCarty
Juan Vargas

CITY OFFICIALS

Jack McGrory
City Manager

Ed Ryan
City Auditor and Comptroller

Charles Abdelnour
City Clerk

Casey Gwinn
City Attorney

Patricia T. Frazier
*Financial and Technical Services
Business Center Manager*

Conny M. Jamison
City Treasurer

PUBLIC FACILITIES FINANCING AUTHORITY OF THE CITY OF SAN DIEGO

BOARD OF DIRECTORS

Jack McGrory
Chairman

Casey Gwinn
Vice Chairman

Ed Ryan
Secretary/Treasurer

CO-BOND COUNSEL

Orrick, Herrington & Sutcliffe LLP
Los Angeles, California

Lofton, De Lancie & Nelson
San Francisco, California

DISCLOSURE COUNSEL

Orrick, Herrington & Sutcliffe LLP
Los Angeles, California

TRUSTEE

State Street Bank and Trust Company
of California, N.A.
Los Angeles, California

FINANCIAL ADVISOR

Public Resources Advisory Group
New York, New York

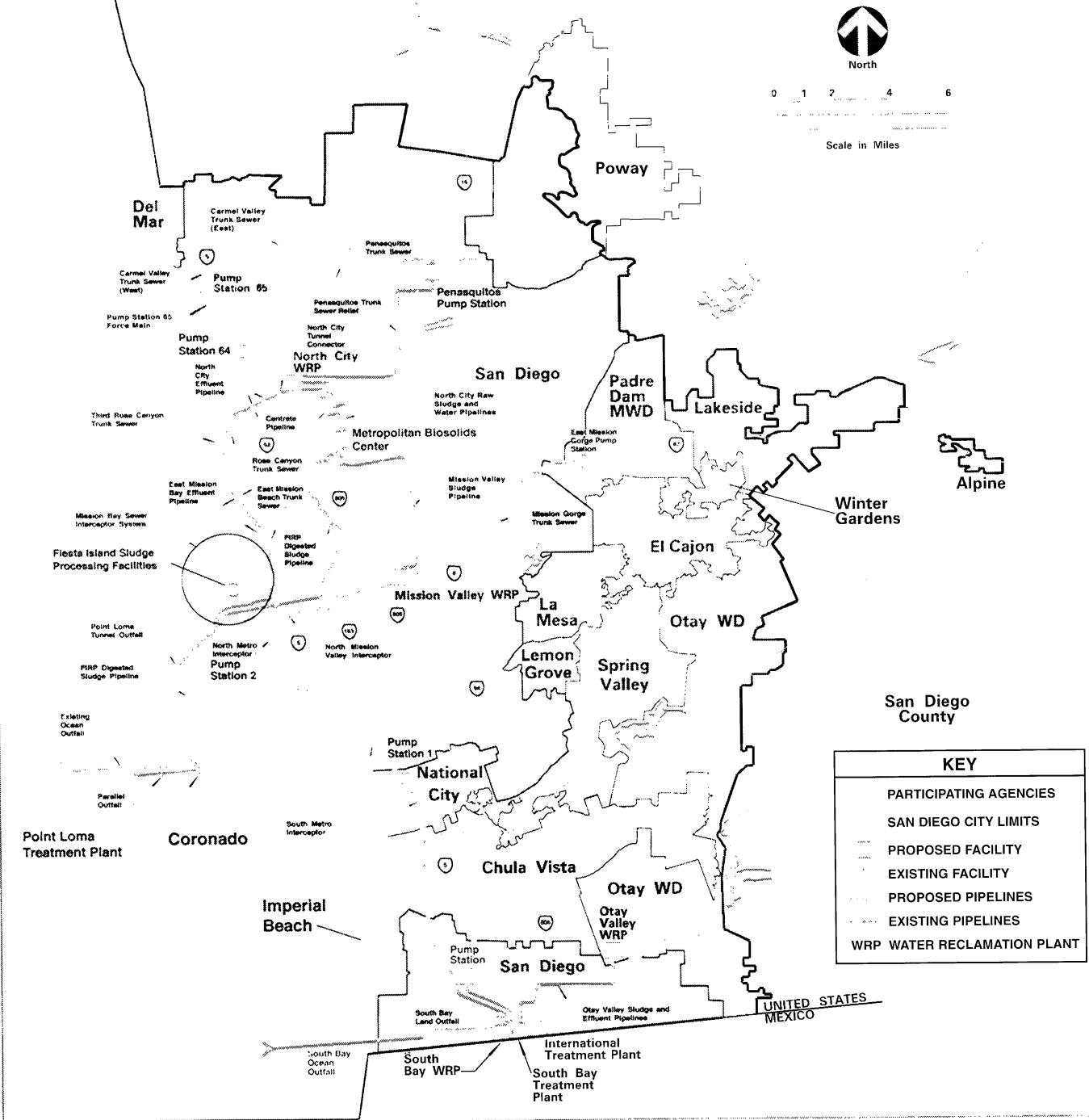
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Metropolitan Sewerage System

Existing and Planned Facilities

Metropolitan Wastewater Plan



SUMMARY STATEMENT

This Summary Statement is qualified in all respects by the more complete information contained elsewhere in this Official Statement, including the Appendices. This Official Statement should be read in its entirety, and no one subject discussed herein should be considered less important than any other by reason of its location in the text. Unless otherwise defined below, all capitalized terms used in this Summary Statement shall have the meanings ascribed thereto in Appendix C to this Official Statement.

City of San Diego

The City is the sixth largest city in the United States and the second largest in the State of California. The City's estimated population for 1996 is approximately 1.2 million.

The San Diego Wastewater System

The Wastewater System is owned and operated by the City under the administration of the Metropolitan Wastewater Department and consists of the Municipal System and Metropolitan System. The Municipal System provides sewage collection within the City and consists of over 2,528 miles of municipal sewer mains and 96 sewer and storm water interceptor pumping stations within the City. The Metropolitan System provides sewage transportation, treatment and disposal services to more than 1.9 million residents within a regional service area which encompasses the City and 14 Participating Agencies (eight incorporated cities and six districts). The communities and agencies served by the Wastewater System form the second largest integrated metropolitan area in the State of California surpassed only by the Los Angeles metropolitan area. See "WASTEWATER SYSTEM."

The operations of the Wastewater System are accounted for in an enterprise fund — the Sewer Revenue Fund which was established by amendment to the City Charter on November 8, 1960. All Wastewater System Revenues are deposited in the Sewer Revenue Fund. The Installment Payments relating to the Series 1997 Bonds and the Outstanding Parity Bonds (defined herein) are, and any Parity Obligations will be, secured by Net System Revenues.

The Authority

The Authority is a joint powers authority created by the City and its Redevelopment Agency to engage in financing activities. The Authority has no taxing power. See "THE AUTHORITY."

Purpose of the Financing

The Series 1997A Bonds are being issued (i) to pay design, engineering, land acquisition and construction costs of certain capital improvements to the Metropolitan System, (ii) to fund a portion of the debt service reserve fund securing the Series 1997 Bonds and the Outstanding Parity Bonds and (iii) to pay certain costs of issuance. The Series 1997B Bonds are being issued (i) to pay design, engineering, land acquisition and construction costs of certain capital improvements to the Municipal System, (ii) to fund a portion of the debt service reserve fund securing the Series 1997 Bonds and the Outstanding Parity Bonds and (iii) to pay certain costs of issuance.

The Series 1997 Bonds

The Series 1997 Bonds will be issued in the aggregate amount of \$250,000,000. The Series 1997 Bonds shall be in denominations of \$5,000 and any integral multiple thereof.

Redemption Provisions

The Series 1997 Bonds are subject to optional redemption with the redemption premiums described herein, and the Series 1997 Bonds designated as Term Bonds are subject to mandatory redemption, all as more fully described herein. See "DESCRIPTION OF THE SERIES 1997 BONDS."

Security for the Series 1997 Bonds

The Series 1997 Bonds are payable solely from Installment Payments from a pledge and lien on Net System Revenues by the City to the Authority under the Installment Purchase Agreement. Net System Revenues are System Revenues less Maintenance and Operation Costs of the Wastewater System.

The City has covenanted in the Installment Purchase Agreement not to discontinue or suspend any Installment Payments whether or not the Project or any part thereof is operating or operable or has been completed, or its use is suspended, interfered with, reduced, curtailed or terminated in whole or in part, and such Installment Payments shall not be subject to reduction whether by offset or otherwise and shall not be conditional upon the performance or non-performance by any party of any agreement for any cause whatsoever.

The obligation of the City to make Installment Payments does not constitute an obligation of the City for which the City is obligated to levy or pledge any form of taxation or for which the City has levied or pledged any form of taxation. Neither the pledge made by the Authority, nor the obligation of the City to make Installment Payments, creates a legal or equitable pledge, charge, lien or encumbrance upon any of the City's property, or upon its income, receipts or revenues other than Net System Revenues. The Authority has no taxing power. See "SECURITY FOR THE SERIES 1997 BONDS."

Bond Insurance

The payment of principal of and interest on the Series 1997 Bonds when due will be insured by a municipal bond insurance policy to be issued simultaneously with the delivery of the Series 1997 Bonds by Financial Guaranty Insurance Company. See "SECURITY FOR THE SERIES 1997 BONDS — Bond Insurance" and "APPENDIX F — SPECIMEN MUNICIPAL BOND INSURANCE POLICY."

Rate Covenant

The City has covenanted in the Installment Purchase Agreement to fix, prescribe and collect rates and charges for the Wastewater System which will be at least sufficient during each fiscal year to pay all Obligations (other than Parity Obligations) and to provide Net System Revenues equal to 120% of the Debt Service for such fiscal year. Net System Revenues may be increased or reduced by transfers in or out of the Rate Stabilization Fund. See "SECURITY FOR THE SERIES 1997 BONDS" and "WASTEWATER SYSTEM FINANCIAL OPERATIONS — Impact of Proposition 218 on Sewer Service Rates and Charges."

Reserve Fund

A Reserve Fund has been established from the proceeds of the Series 1997 Bonds and the Outstanding Parity Bonds in an amount equal to the Reserve Requirement. The Reserve Requirement, as of any date of calculation, shall be the least of (i) 10% of the proceeds of the Series 1997 Bonds and the Outstanding Parity Bonds, (ii) Maximum Annual Debt Service on the Series 1997 Bonds and the Outstanding Parity Bonds for the then current or any future fiscal year, or (iii) 125% of average Annual Debt Service on the Series 1997 Bonds and Outstanding Parity Bonds.

Outstanding Parity Bonds

The City has outstanding \$588,285,000 in Parity Obligations incurred in connection with the issuance of the Authority's \$350,000,000 original aggregate principal amount of Sewer Revenue Bonds, Series 1995 (Payable Solely From Installment Payments Secured By Wastewater System Net Revenues) and the Authority's \$250,000,000 original aggregate principal amount of Sewer Revenue Bonds, Series 1993 (Payable Solely From Installment Payments Secured By Wastewater System Net Revenues) (collectively, the "Outstanding Parity Bonds").

Additional Parity Obligations

The City may at any time issue or create other Parity Obligations on a parity with the Installment Payments pledged to the payment of the Series 1997 Bonds and the Outstanding Parity Bonds; provided the City obtains or provides a certificate or certificates, prepared by the City or at the City's option by a

Consultant, showing (i) the Net System Revenues as shown by the books of the City for any 12 consecutive month period out of the 18 consecutive months ending immediately prior to the incurring of such other Parity Obligations shall have amounted to at least 1.20 times the Maximum Annual Debt Service on all Parity Obligations Outstanding during such period; and (ii) the estimated Net System Revenues for the next 12 months following the date of issuance of such other Parity Obligations will be at least equal to 1.20 times the Maximum Annual Debt Service for all Parity Obligations which will be Outstanding immediately after the issuance of the proposed Parity Obligations. See "SECURITY FOR THE SERIES 1997 BONDS."

Possible Transfer of Ownership of Metropolitan System

Under the Installment Purchase Agreement, the City has retained the right to transfer ownership of the Metropolitan System to another governmental entity whose primary purpose is the provision of wastewater services provided its transferee assumes all obligations of the City under the Installment Purchase Agreement relating to the Metropolitan System and satisfies the terms and conditions contained in the Installment Purchase Agreement with respect to such transfer. Upon any transfer the City will no longer be responsible for such obligations. See "POSSIBLE TRANSFER OF OWNERSHIP OF METROPOLITAN SYSTEM."

Special Considerations For Bondholders

See "SPECIAL CONSIDERATIONS FOR BONDHOLDERS" for a description of certain risk factors relating to the Series 1997 Bonds.

Continuing Disclosure and Additional Information

See "CONTINUING DISCLOSURE" regarding the City's obligation to provide annual financial information and information regarding the occurrence of certain events. Copies of the Indenture, the Installment Purchase Agreement, the Continuing Disclosure Agreement, the City Charter, the Sewer Revenue Fund audited financial statements and additional information relating to the City and the Series 1997 Bonds may be obtained from the Office of the City Clerk, City Administration Building, 202 C Street, MS 2A, San Diego, California 92101.

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\$250,000,000

**PUBLIC FACILITIES FINANCING AUTHORITY
OF THE CITY OF SAN DIEGO
SEWER REVENUE BONDS, SERIES 1997A AND SERIES 1997B**

*(Payable Solely From Installment Payments
Secured by Wastewater System Net Revenues)*

INTRODUCTION

This Official Statement, which includes the cover page and appendices hereto, is being furnished in connection with the issuance by the Public Facilities Financing Authority of the City of San Diego (the "Authority") of its \$250,000,000 aggregate principal amount of Sewer Revenue Bonds, Series 1997A and Series 1997B (Payable Solely From Installment Payments Secured By Wastewater System Net Revenues) (individually, the "Series 1997A Bonds" and the "Series 1997B Bonds" or a "Series" and together, the "Series 1997 Bonds"). The Series 1997 Bonds will be issued on a parity with the Authority's Sewer Revenue Bonds, Series 1995 (Payable Solely From Installment Payments Secured by Wastewater System Net Revenues) (the "Series 1995 Bonds") issued in the original aggregate principal amount of \$350,000,000, all of which is currently outstanding and the Authority's Sewer Revenue Bonds, Series 1993 (Payable Solely From Installment Payments Secured by Wastewater System Net Revenues) (the "Series 1993 Bonds"), issued in the original aggregate principal amount of \$250,000,000, \$238,285,000 of which is currently outstanding (the Series 1995 Bonds and the Series 1993 Bonds are collectively referred to as the "Outstanding Parity Bonds"). The Master Installment Purchase Agreement and the 1993-1 Supplement to the Master Installment Purchase Agreement, each dated as of September 1, 1993, the 1995-1 Supplement to the Master Installment Purchase Agreement, dated as of December 1, 1995 and the 1997-1 Supplement to the Master Installment Purchase Agreement, dated as of February 1, 1997, each between the Authority and the City of San Diego (the "City") (the Master Installment Purchase Agreement together with the 1993-1 Supplement to the Master Installment Purchase Agreement, the 1995-1 Supplement to the Master Installment Purchase Agreement, the 1997-1 Supplement to the Master Installment Purchase Agreement and any other Supplements thereto, are collectively referred to as the "Installment Purchase Agreement"), provides for the sale of certain facilities to the City by the Authority in consideration of the City's payment of Installment Payments to the Authority in an amount equal to the principal and interest on the Series 1997 Bonds and the Outstanding Parity Bonds. The Indenture, dated as of September 1, 1993 (the "Original Indenture"), between the Authority and State Street Bank and Trust Company of California, N.A., as Trustee (the "Trustee"), as supplemented by the First Supplemental Indenture, dated as of May 1, 1994, the Second Supplemental Indenture, dated as of December 1, 1995 and the Third Supplemental Indenture, dated as of February 1, 1997, each between the Authority and the Trustee (the First Supplemental Indenture, the Second Supplemental Indenture, the Third Supplemental Indenture, together with the Original Indenture, are collectively referred to as the "Indenture"), provides for the issuance of the Series 1997 Bonds. The Series 1997 Bonds are being issued pursuant to the provisions of the Joint Powers Act, comprising Article 1, Article 2 and Article 4 (commencing with Section 6500) of Chapter 5 of Division 7 of Title 1 of the Government Code of the State of California. Capitalized terms not otherwise defined herein shall have the meaning given to such terms in "APPENDIX C - DEFINITIONS OF CERTAIN TERMS."

The Series 1997 Bonds are special, limited obligations of the Authority payable solely from and secured by Installment Payments made by the City to the Authority from Net System Revenues pursuant to the Installment Purchase Agreement. Installment Payments are in an amount equal to the principal and interest due on the Series 1997 Bonds and the Outstanding Parity Bonds. System Revenues consist primarily of moneys derived by the City from the ownership and operation of the Wastewater System. Net System Revenues are System Revenues less Maintenance and Operation Costs of the Wastewater System. The City has pledged and assigned Net System Revenues pursuant to the Installment Purchase Agreement to the payment of the Installment Payments. Pursuant to the Indenture, the Authority has irrevocably pledged the Installment Payments to the payment of principal and interest on the Series 1997 Bonds and the Outstanding Parity Bonds. See "SECURITY FOR THE SERIES 1997 BONDS."

The Installment Purchase Agreement defines the Wastewater System to be any and all facilities, properties and improvements at any time owned, controlled or operated by the City as part of the Sewer Revenue Fund, including the Municipal System and the Metropolitan System. The Municipal System consists of the facilities, properties and improvements of the City for the collection and treatment of sewage from points of origination within the City and the conveyance of sewage to the Metropolitan System. The Metropolitan System consists of the facilities, properties and improvements, designated by the City in its sole discretion as part of the Metropolitan System, used for the treatment, discharge and disposal of sewage collected by the City through the Municipal System or by any of the Participating Agencies (defined herein).

See "POSSIBLE TRANSFER OF OWNERSHIP OF METROPOLITAN SYSTEM" for information regarding the power of the City to transfer ownership of the Metropolitan System and to then be discharged from its obligations with respect to the Series 1997A Bonds and the Outstanding Parity Bonds.

The Installment Purchase Agreement authorizes the Authority to acquire certain components of the Project with the proceeds of the Series 1997 Bonds and to sell such components of the Project to the City in consideration of the City's payment of Installment Payments to the Authority. The Project consists of design and engineering costs, costs of land acquisition, construction and other initial costs relating to certain capital improvements to the Metropolitan System and Municipal System.

The obligation of the City to make Installment Payments does not constitute an obligation of the City for which the City is obligated to levy or pledge any form of taxation or for which the City has levied or pledged any form of taxation. Neither the pledge made by the Authority, nor the obligation of the City to make Installment Payments, creates a legal or equitable pledge, charge, lien or encumbrance upon any of the City's property, or upon its income, receipts or revenues other than Net System Revenues. The Authority has no taxing power.

The descriptions and summaries of various documents in this Official Statement are qualified in their entirety by reference to such documents. Copies of the Indenture, the Installment Purchase Agreement, the Continuing Disclosure Agreement, the City Charter, the Sewer Revenue Fund audited financial statements and additional information relevant to the City and the Series 1997 Bonds may be obtained from the Office of the City Clerk, City Administration Building, 202 C Street, MS 2A, San Diego, California 92101.

DESCRIPTION OF THE SERIES 1997 BONDS

General Terms

The Series 1997 Bonds will be issued in two series in the aggregate principal amounts, will bear interest at the rates per annum and will mature in the principal amounts in each year (subject to prior redemption), as set forth on the inside cover page hereof. The Series 1997 Bonds are issuable only in fully registered form and, when issued, will be registered in the name of Cede & Co., as registered owner and nominee of The Depository Trust Company, New York, New York ("DTC"). DTC will act as securities depository for the Series 1997 Bonds. Purchasers will not receive certificates representing their interest in the Series 1997 Bonds purchased. See "Book-Entry-Only System" below.

The Series 1997 Bonds may be transferred on the registration books of the Trustee kept for that purpose at its principal corporate trust office. The Trustee shall not be required to register the transfer of any Series 1997 Bond (i) during the period commencing on the day 5 Business Days before the date on which the Series 1997 Bonds are to be selected for redemption and ending on such date of selection, or (ii) which has been selected for redemption in whole or in part. Similarly, the Trustee shall not be required to register the exchange of any Series 1997 Bond (i) during any period commencing with the close of business on the 15th day next preceding any interest payment date and ending on such interest payment date, (ii) during the period commencing 15 days before the mailing of any notice of redemption and ending on the day of such mailing or (iii) which has been selected for redemption in whole or in part.

The Series 1997 Bonds will be paid to the person in whose name such Bond is registered on the applicable record date, which is the 15th day (whether or not such day is a Business Day) preceding each interest payment date. Interest on the Series 1997 Bonds will be payable by check of the Trustee, mailed to the registered owners at the addresses shown on the registration books of the Trustee kept for that purpose at its principal corporate trust office as of the close of business on the applicable record date; provided, however, if the Series 1997 Bonds are in certificated form, interest shall be payable by wire transfer to registered owners who own Series 1997 Bonds in the principal amount of not less than \$1,000,000. The principal and redemption price of all Series 1997 Bonds will be payable at the principal corporate trust office of the Trustee.

Series 1997 Bonds

The Series 1997 Bonds will be dated February 1, 1997 and interest thereon will accrue from such date. Beneficial ownership of Series 1997 Bonds may be purchased in denominations of \$5,000 or any integral multiple thereof in book-entry form only. Interest on the Series 1997 Bonds is payable on May 15 and November 15 of each year, commencing November 15, 1997. The Series 1997 Bonds will mature on the dates and in the aggregate principal amounts (subject to prior redemption), and will bear interest at the per annum rates, set forth on the inside cover page of this Official Statement.

Optional Redemption. The Series 1997A Bonds and the Series 1997B Bonds maturing on or before May 15, 2007, are not subject to redemption prior to maturity. If the City elects its option to prepay Installment Payments under the terms of the Installment Purchase Agreement, the Series 1997A Bonds and the Series 1997B Bonds maturing on May 15, 2008 through and including May 15, 2027 are each separately subject to redemption prior to their stated maturities on or after May 15, 2007, in whole or in part on any date (if in part for either Series, in maturities selected by the Authority and by lot within any maturity for each Series), at the redemption prices set forth below (expressed as a percentage of the principal amount, or portion thereof, to be prepaid), plus accrued interest to the date fixed for redemption:

<u>Redemption Period</u> <u>(Both dates inclusive)</u>	<u>Redemption</u> <u>Price</u>
May 15, 2007 through May 14, 2008	101.0%
May 15, 2008 through May 14, 2009	100.5
May 15, 2009 and thereafter	100.0

Mandatory Sinking Fund Redemption - Series 1997A Bonds. The Series 1997A Bonds maturing on May 15, 2022 and May 15, 2027 (collectively, the "1997A Term Bonds") are subject to mandatory sinking fund redemption at a redemption price equal to the principal amount thereof without premium plus accrued interest to the redemption date.

The Series 1997A Bonds maturing on May 15, 2022 shall be redeemed on May 15 in the years and in the principal amounts set forth in the table below:

<u>Year</u>	<u>Principal Amount</u>
2018	\$7,300,000
2019	7,685,000
2020	8,085,000
2021	8,510,000
2022*	8,960,000

* Maturity

The Series 1997A Bonds maturing on May 15, 2027 shall be redeemed on May 15 in the years and in the principal amounts set forth in the table below:

<u>Year</u>	<u>Principal Amount</u>
2023	\$ 9,430,000
2024	9,925,000
2025	10,445,000
2026	10,995,000
2027*	11,570,000

* Maturity

Mandatory Sinking Fund Redemption - Series 1997B Bonds. The Series 1997B Bonds maturing on May 15, 2022 and May 15, 2027 (collectively, the "1997B Term Bonds" and together with the 1997A Term Bonds, the "Term Bonds") are subject to mandatory sinking fund redemption at a redemption price equal to the principal amount thereof without premium plus accrued interest to the redemption date.

The Series 1997B Bonds maturing on May 15, 2022 shall be redeemed on May 15 in the years and in the principal amounts set forth in the table below:

<u>Year</u>	<u>Principal Amount</u>
2018	\$2,675,000
2019	2,815,000
2020	2,960,000
2021	3,115,000
2022*	3,280,000

* Maturity

The Series 1997B Bonds maturing on May 15, 2027 shall be redeemed on May 15 in the years and in the principal amounts set forth in the table below:

<u>Year</u>	<u>Principal Amount</u>
2023	\$3,450,000
2024	3,635,000
2025	3,825,000
2026	4,205,000
2027*	4,235,000

* Maturity

Credit Against Mandatory Sinking Fund Requirement. At the option of the Authority, it may credit against any mandatory sinking fund requirement Term Bonds or portions thereof which are of the same maturity and Series as the Term Bonds subject to mandatory redemption and which, prior to said date, have been purchased, with funds other than moneys in a Sinking Account, at public or private sale or redeemed and canceled by the Authority and not theretofore applied as a credit against any mandatory sinking fund requirement. The Authority and the City may also elect to have moneys in the Sinking Account applied to the purchase of Term Bonds which in turn shall be credited against any mandatory sinking fund redemption requirement, all as provided for in the Indenture. If, during the 12-month period immediately preceding said mandatory sinking account payment date, the Trustee has purchased Term Bonds of such maturity and Series with moneys in such Sinking Account, such Bonds so purchased shall be applied, to the extent of the full principal amount thereof, to reduce said mandatory sinking account payment.

Notice of Redemption. Notice of redemption shall be given by the Trustee not less than 30 days nor more than 60 days prior to the redemption date to (i) the respective Owners of the Series 1997 Bonds designated for redemption at their addresses appearing on the registration books of the Trustee by first class mail, and (ii) the Securities Depositories and the Information Services by certified or registered mail or overnight delivery. Each notice of redemption shall state the date of such redemption, the redemption price, if any, the name and appropriate address of the Trustee, the Series, the CUSIP number, if any, of the maturity or maturities of such Series, and, if less than all of any such maturity and Series is to be redeemed, the distinctive certificate numbers of the Series 1997 Bonds of such maturity and Series to be redeemed and, in the case of Series 1997 Bonds of any Series to be redeemed in part only, the respective portions of the principal amount thereof to be redeemed. Each such notice shall also state that on said date there will become due and payable on each of said Series 1997 Bonds thereof and in the case of a Series 1997 Bond of any Series to be redeemed in part only, the specified portion of the principal amount thereof to be redeemed, together with interest accrued thereon to the redemption date, and that from and after such redemption date interest thereon shall cease to accrue, and shall require that such Series 1997 Bonds be then surrendered at the address of the Trustee specified in the redemption notice.

Book-Entry-Only System

The information contained in the following paragraphs of this subsection "Book-Entry-Only System" has been extracted from a schedule prepared by DTC entitled "SAMPLE OFFICIAL STATEMENT LANGUAGE DESCRIBING BOOK-ENTRY-ONLY ISSUANCE." The Authority and the City make no representation as to the completeness or the accuracy of such information or as to the absence of material adverse changes in such information subsequent to the date hereof.

1. DTC will act as securities depository for the Series 1997 Bonds. The Series 1997 Bonds will be issued as fully registered securities in the names of Cede & Co. (DTC's partnership nominee). One fully registered Series 1997 Bonds certificate will be issued for each maturity of each Series of the Series 1997 Bonds, each in the aggregate principal amount of such maturity of such Series, and will be deposited with DTC. If, however, the aggregate principal amount of any maturity of such Series exceeds \$150 million, one certificate will be issued with respect to each \$150 million of principal amount and an additional certificate will be issued with respect to any remaining principal amount of such issue.

2. DTC is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds securities that its participants ("Participants") deposit with DTC. DTC also facilitates the settlement among Participants of securities transactions, such as transfers and pledges, in deposited securities through electronic computerized book-entry changes in Participants' accounts, thereby eliminating the need for physical movement of securities certificates. Direct Participants include securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is owned by a number of its Direct Participants and by the New York Stock Exchange, Inc., the American Stock Exchange, Inc., and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as securities brokers and dealers, banks, and trust companies that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). The rules applicable to DTC and its Participants are on file with the Securities and Exchange Commission.

3. Purchases of Series 1997 Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Series 1997 Bonds on DTC's records. The ownership interest of each actual purchaser of each Series 1997 Bond ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase, but Beneficial Owners are expected to receive written confirmation providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in Series 1997 Bonds are to be accomplished by entries made on the books of Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive

certificates representing their ownership interest in Series 1997 Bonds, except in the event that use of the book-entry system for the Series 1997 Bonds is discontinued.

4. To facilitate subsequent transfers, all Series 1997 Bonds deposited by Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co. The deposit of Series 1997 Bonds with DTC and their registration in name of Cede & Co., effects no change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Series 1997 Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Series 1997 Bonds are credited, which may or may not be the Beneficial Owners. The Participants will remain responsible for keeping account of their holdings on behalf of their customers.

5. Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time.

6. Redemption notices shall be sent to Cede & Co. If less than all of the Series 1997A Bonds or the Series 1997B Bonds are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such Series to be redeemed.

7. Neither DTC nor Cede & Co. will consent or vote with respect to the Series 1997 Bonds. Under its usual procedures, DTC mails an Omnibus Proxy to the Authority as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the Series 1997 Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

8. Principal and interest on the Series 1997 Bonds will be made to DTC. DTC's practice is to credit Direct Participants' accounts on payable date in accordance with their respective holdings shown on DTC's records unless DTC has reason to believe that it will not receive payment on payable date. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as in the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC, the Trustee, or the Authority, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal and interest to DTC is the responsibility of the Authority or the Trustee, disbursement of such payments to Direct Participants shall be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners shall be the responsibility of Direct and Indirect Participants.

9. DTC may discontinue providing its services as securities depository with respect to the Series 1997 Bonds at any time by giving reasonable notice to the Authority or the Trustee. Under such circumstances, in the event that a successor securities depository is not obtained, Series 1997 Bonds will be printed and delivered.

10. The Authority may decide to discontinue use of the system book-entry transfers through DTC (or a successor securities depository). In that event, Series 1997 Bond certificates will be printed and delivered.

11. The information in this section concerning DTC and DTC's book-entry system has been obtained from sources that the Authority believes to be reliable, but the Authority takes no responsibility for the accuracy thereof.

NONE OF THE AUTHORITY, THE CITY OR THE UNDERWRITERS WILL HAVE ANY RESPONSIBILITY OR OBLIGATION TO PARTICIPANTS, TO INDIRECT PARTICIPANTS OR TO ANY BENEFICIAL OWNER WITH RESPECT TO (I) THE ACCURACY OF ANY RECORDS MAINTAINED BY DTC, ANY PARTICIPANT, OR ANY INDIRECT PARTICIPANT; (II) THE PAYMENT BY DTC OR ANY PARTICIPANT OR INDIRECT PARTICIPANT OF ANY AMOUNT WITH RESPECT TO THE PRINCIPAL OF, OR PREMIUM, IF ANY, OR INTEREST ON, THE SERIES 1997 BONDS; (III) ANY NOTICE WHICH IS PERMITTED OR REQUIRED TO BE GIVEN TO BONDOWNERS; (IV) ANY CONSENT GIVEN BY DTC OR OTHER ACTION TAKEN BY DTC AS BONDOWNER; OR (V) THE SELECTION BY DTC OR ANY

PARTICIPANT OR INDIRECT PARTICIPANT OF ANY BENEFICIAL OWNERS TO RECEIVE PAYMENT IN THE EVENT OF A PARTIAL REDEMPTION OF THE SERIES 1997 BONDS.

Purpose of Financing

The proceeds of the Series 1997A Bonds will be used for Metropolitan System capital improvements and the proceeds of Series 1997B Bonds will be used for Municipal System capital improvements. (See "WASTEWATER SYSTEM CAPITAL IMPROVEMENT PROGRAM.") For both the Metropolitan and the Municipal Systems, capital improvement costs include costs of design, engineering, legal and administrative services, acquisition of rights-of-way, land acquisition, construction and equipment. In addition to funding certain Metropolitan System capital improvements, the remaining proceeds of the Bonds will be used to fund a portion of the debt service reserve fund securing the Series 1997 Bonds and the Outstanding Parity Bonds and to pay certain costs of issuance. The remaining proceeds of the Series 1997B Bonds will be used to fund a portion of the debt service reserve fund securing the Series 1997 Bonds and the Outstanding Parity Bonds and to pay certain costs of issuance.

Application of Series 1997 Bond Proceeds

The proceeds of the Series 1997 Bonds (excluding accrued interest which will be deposited in the Interest Account in the Payment Fund) are to be applied as follows:

	<u>Series 1997A Bonds</u>	<u>Series 1997B Bonds</u>	<u>Total</u>
Principal Amount	\$183,000,000	\$67,000,000	\$250,000,000
Less Original Issue Discount	<u>(4,958,745)</u>	<u>(1,815,436)</u>	<u>(6,774,181)</u>
Total Available Funds	\$178,041,255	\$65,184,564	\$243,225,819
Deposit to Acquisition Fund Account ⁽¹⁾	\$163,557,597	\$59,881,808	\$223,439,405
Deposit to Reserve Fund ⁽²⁾	13,002,831	4,760,599	17,763,430
Cost of Issuance	660,570	241,845	902,415
Underwriters' Discount	<u>820,257</u>	<u>300,312</u>	<u>1,120,569</u>
Total Amount Applied	\$178,041,255	\$65,184,564	\$243,225,819

⁽¹⁾ To be held by the City and applied to pay Metropolitan System Acquisition Costs with respect to the Series 1997A Bonds and Municipal System Acquisition Costs with respect to the Series 1997B Bonds.

⁽²⁾ This deposit, together with the amounts currently on deposit in the Reserve Fund held by the Trustee with respect to the Outstanding Parity Bonds, comprise an amount equal to the Reserve Requirement.

Debt Service Requirements

The following table shows the total debt service requirements from Net System Revenues with respect to the Series 1997A Bonds, the Series 1997B Bonds and the Outstanding Parity Bonds.

Table 1
TOTAL DEBT SERVICE REQUIREMENTS

<u>Year Ending June 30</u>	<u>Series 1997A Bonds</u>		<u>Series 1997B Bonds</u>		<u>Outstanding Parity Bonds</u>		<u>Total Debt Service</u>
	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>	
1997		\$2,692,584.92		\$ 985,802.64	\$ 4,660,000	\$14,551,355.01	\$22,889,742.57
1998	\$ 2,860,000	9,320,486.25	\$1,045,000	3,412,393.75	10,960,000	28,939,610.00	56,537,490.00
1999	2,965,000	9,214,666.25	1,085,000	3,373,728.75	11,380,000	28,519,400.00	56,537,795.00
2000	3,080,000	9,099,031.25	1,130,000	3,331,413.75	11,840,000	28,064,200.00	56,544,645.00
2001	3,205,000	8,972,751.25	1,175,000	3,285,083.75	12,325,000	27,578,760.00	56,541,595.00
2002	3,340,000	8,838,141.25	1,225,000	3,235,733.75	12,845,000	27,057,655.00	56,541,530.00
2003	3,485,000	8,692,851.25	1,275,000	3,182,446.25	13,395,000	26,505,320.00	56,535,617.50
2004	3,640,000	8,536,026.25	1,335,000	3,125,071.25	13,985,000	25,917,817.50	56,538,915.00
2005	3,810,000	8,368,586.25	1,395,000	3,063,661.25	14,615,000	25,288,492.50	56,540,740.00
2006	3,990,000	8,189,516.25	1,460,000	2,998,096.25	15,405,000	24,499,867.50	56,542,480.00
2007	4,180,000	7,997,996.25	1,530,000	2,928,016.25	16,245,000	23,659,567.50	56,540,580.00
2008	4,385,000	7,793,176.25	1,605,000	2,853,046.25	17,135,000	22,769,347.50	56,540,570.00
2009	4,605,000	7,573,926.25	1,685,000	2,772,796.25	17,970,000	21,934,016.25	56,540,738.75
2010	4,835,000	7,343,676.25	1,770,000	2,688,546.25	18,845,000	21,056,045.00	56,538,267.50
2011	5,080,000	7,097,091.25	1,860,000	2,598,276.25	19,780,000	20,121,910.00	56,537,277.50
2012	5,345,000	6,832,931.25	1,955,000	2,501,556.25	20,785,000	19,116,005.00	56,535,492.50
2013	5,625,000	6,552,318.75	2,060,000	2,398,918.75	21,845,000	18,058,980.00	56,540,217.50
2014	5,920,000	6,257,006.25	2,170,000	2,290,768.75	22,960,000	16,941,810.00	56,539,585.00
2015	6,240,000	5,938,806.25	2,285,000	2,174,131.25	24,160,000	15,742,962.50	56,540,900.00
2016	6,575,000	5,603,406.25	2,405,000	2,051,312.50	25,395,000	14,509,037.50	56,538,756.25
2017	6,930,000	5,250,000.00	2,535,000	1,922,043.75	26,690,000	13,212,000.00	56,539,043.75
2018	7,300,000	4,877,512.50	2,675,000	1,785,787.50	28,050,000	11,848,775.00	56,537,075.00
2019	7,685,000	4,494,262.50	2,815,000	1,645,350.00	29,485,000	10,416,050.00	56,540,662.50
2020	8,085,000	4,090,800.00	2,960,000	1,497,562.50	30,995,000	8,909,987.50	56,538,350.00
2021	8,510,000	3,666,337.50	3,115,000	1,342,162.50	32,575,000	7,326,750.00	56,535,250.00
2022	8,960,000	3,219,562.50	3,280,000	1,178,625.00	34,200,000	5,698,000.00	56,536,187.50
2023	9,430,000	2,749,162.50	3,450,000	1,006,425.00	35,910,000	3,988,000.00	56,533,587.50
2024	9,925,000	2,254,087.50	3,635,000	825,300.00	21,390,000	2,192,500.00	40,221,887.50
2025	10,445,000	1,733,025.00	3,825,000	634,462.50	22,460,000	1,123,000.00	40,220,487.50
2026	10,995,000	1,184,662.50	4,025,000	433,650.00			16,638,312.50
2027	11,570,000	607,425.00	4,235,000	222,337.50			16,634,762.50

SECURITY FOR THE SERIES 1997 BONDS

Source of Payment

The Series 1997 Bonds are payable solely from Installment Payments made by the City from Net System Revenues pursuant to the Installment Purchase Agreement and will be issued on a parity with the Outstanding Parity Bonds. See "SECURITY FOR THE SERIES 1997 BONDS - Outstanding Parity Bonds." All Parity Obligations, including the Installment Payments pledged to the payment of the Series 1997 Bonds and the Outstanding Parity Bonds, shall be secured by a lien on and pledge of Net System Revenues, and within such lien priority, Parity Obligations shall be of equal rank without preference, priority or distinction of any Parity Obligations over any other Parity Obligations. Such lien and pledge shall constitute a first lien on Net System Revenues; provided, however, that out of Net System Revenues there may be apportioned such sums for such purposes as are expressly permitted by the Installment Purchase Agreement.

The Sewer Revenue Fund

The City accounts for its wastewater operations through an enterprise fund known as the Sewer Revenue Fund. The Sewer Revenue Fund was established by amendment to the City Charter on November 8, 1960 and is held separate and apart from other funds of the City.

All System Revenues are deposited in the Sewer Revenue Fund. All moneys in the Sewer Revenue Fund are held in trust separate and apart from any other funds of the City and shall be used to pay (i) all Maintenance and Operation Costs of the Wastewater System and (ii) all Parity Obligations, including Installment Payments equal to the principal and interest on the Series 1997 Bonds and the Outstanding Parity Bonds. After such payments have been made, any remaining System Revenues shall be used to make up any deficiency in the Reserve Fund for Parity Obligations and, subject to certain conditions, then may be used to pay for capital expenditures for the Wastewater System or any other Wastewater System purposes, including the payment of Subordinated Obligations, if any.

Net System Revenues

Net System Revenues are System Revenues less Maintenance and Operation Costs of the Wastewater System. System Revenues are defined in the Installment Purchase Agreement to include all income, rents, rates, fees, charges and other moneys derived from the ownership or operation of the Wastewater System. Notwithstanding the foregoing, there shall be deducted from System Revenues any amounts transferred into the Rate Stabilization Fund, and there shall be added to System Revenues any amounts transferred out of such Rate Stabilization Fund to pay Maintenance and Operation Costs of the Wastewater System. See "Rate Stabilization Fund; Impact of Proposition 218" below. Under the Installment Purchase Agreement, the City has retained the right to transfer ownership of the Metropolitan System. For a more detailed description of this potential transfer of ownership, see "POSSIBLE TRANSFER OF OWNERSHIP OF METROPOLITAN SYSTEM." Upon any such transfer of the Metropolitan System permitted by the Installment Purchase Agreement, System Revenues shall be deemed to consist of Municipal System Revenues with respect to the City and Metropolitan System Revenues with respect to the transferee. For a more detailed description of System Revenues, Metropolitan System Revenues and Municipal System Revenues, see "APPENDIX C - DEFINITIONS OF CERTAIN TERMS."

Maintenance and Operations Costs of the Wastewater System are defined in the Installment Purchase Agreement to include, among other things (i) a Qualified Take or Pay Obligation; (ii) fees and expenses of a Credit Provider (exclusive of payment of Credit Provider Reimbursement Obligations); and (iii) the reasonable and necessary costs spent or incurred by the City for maintaining and operating the Wastewater System, calculated in accordance with generally accepted accounting principles, but excluding in all cases (a) depreciation, replacement and obsolescence charges or reserves therefor, (b) amortization of intangibles or other bookkeeping entries of a similar nature, (c) costs of capital additions, replacements, betterments, extensions or improvements to the Wastewater System, which under generally accepted accounting principles are chargeable to a capital account or to a reserve for depreciation, (d) charges for the payment of principal and interest on any general obligation bond theretofore or hereafter issued for Wastewater System purposes, and (e) charges for the payment of principal and interest on any debt service on account of any obligation on a parity with or subordinate to the Installment

Payments. Qualified Take or Pay Obligation means the obligation of the City to make use of any facility, property or services, or some portion of the capacity thereof, or to pay therefor from System Revenues, or both, whether or not such facilities, properties or services are ever made available to the City for use, and there is provided to the City a certificate of an Independent Engineer to the effect that the incurrence of such obligation will not adversely affect the ability of the City to comply with the rate covenant contained in the Installment Purchase Agreement. Under the Installment Purchase Agreement, the City has retained the right to transfer ownership of the Metropolitan System. For a more detailed description of this potential transfer of ownership, see "POSSIBLE TRANSFER OF OWNERSHIP OF METROPOLITAN SYSTEM." Upon any such transfer of the Metropolitan System permitted by the Installment Purchase Agreement, Maintenance and Operations Costs of the Wastewater System shall be deemed to be Maintenance and Operations Costs of the Municipal System with respect to the City and Maintenance and Operations Costs of the Metropolitan System with respect to the transferee. For a more detailed description of Maintenance and Operations Costs of the Wastewater System, the Metropolitan System and the Municipal System, respectively, see "APPENDIX C - DEFINITIONS OF CERTAIN TERMS."

Obligation of City Under Installment Purchase Agreement

Pursuant to the Installment Purchase Agreement, the City commits, absolutely and unconditionally, to make Installment Payments to the Authority solely from Net System Revenues until such time as the Purchase Price for the Components of the Project financed has been paid in full (or provision for the payment thereof has been made pursuant to the Indenture). The City will not discontinue or suspend any Installment Payments whether or not the Project or any part thereof is operating or operable or has been completed, or its use is suspended, interfered with, reduced, curtailed or terminated in whole or in part, and such Installment Payments shall not be subject to reduction whether by offset or otherwise and shall not be conditioned upon the performance or non-performance by any party of any agreement for any cause whatsoever.

Rate Covenant; Impact of Proposition 218

The City has covenanted in the Installment Purchase Agreement to fix, prescribe and collect rates and charges for wastewater service which during each fiscal year will be at least sufficient (i) to pay all Obligations (other than Parity Obligations) and (ii) to yield Net System Revenues equal to 120% of the Debt Service for such fiscal year. The City may make adjustments from time to time in such rates and charges including reclassification of users as it deems necessary, but shall not reduce the rates and charges then in effect unless the Net System Revenues from such reduced rates and charges will at all times be sufficient to meet the requirements of the Installment Purchase Agreement. However, for information on the possible limitation on the City's ability to comply with the rate covenant, see "WASTEWATER SYSTEM FINANCIAL OPERATIONS - Impact of Proposition 218 on Sewer Service Rates and Charges."

Rate Stabilization Fund; Impact of Proposition 218

The City has established as a fund within the Sewer Revenue Fund, a Rate Stabilization Fund. From time to time, the City may deposit into the Rate Stabilization Fund, from current System Revenues, such amounts as the City shall determine and the amount of available current System Revenues shall be reduced by the amount so transferred. From time to time the City may transfer amounts on deposit in the Rate Stabilization Fund to the Sewer Revenue Fund solely to pay Maintenance and Operation Costs, and any amounts so transferred shall be deemed System Revenues when so transferred. All interest or other earnings upon amounts in the Rate Stabilization Fund may be withdrawn therefrom and accounted for as System Revenues. However, for information on the possible limitation on the City's ability to set rates and charges at levels which would permit the City to make deposits into the Rate Stabilization Fund, see "WASTEWATER SYSTEM FINANCIAL OPERATIONS - Impact of Proposition 218 on Sewer Service Rates and Charges." See also Table 14 and paragraph 4 under the caption "FINANCIAL PROJECTIONS - Projected Operating Results" for currently anticipated deposits into and withdrawals from the Rate Stabilization Fund incident to the currently contemplated Wastewater System Capital Improvement Program.

Pledge Under the Indenture

Pursuant to the Indenture, the Authority has irrevocably pledged all Revenues and amounts on deposit in the funds and accounts established under the Indenture (other than amounts on deposit in the Rebate Fund) to the payments of principal and interest on the Series 1997 Bonds and the Outstanding Parity Bonds. The Indenture defines the term "Revenues" to mean all Installment Payments paid by the City pursuant to the Installment Purchase Agreement, including interest or profits from the investment of money in any account or fund (other than the Rebate Fund). In order to secure the pledge of the Revenues, the Authority has transferred, conveyed and assigned to the Trustee, for the benefit of the Owners, all of the Authority's rights under the Installment Purchase Agreement (excluding its right to indemnification thereunder), including the right to receive Installment Payments from the City, the right to receive any proceeds of insurance maintained thereunder or any condemnation award rendered with respect to the Project, and the right to exercise any remedies provided therein in the event of a default by the City thereunder.

The Trustee has established and will maintain special trust funds to be held by the Trustee called the Payment Fund and the Reserve Fund. Within the Payment Fund, the Trustee has established and will maintain the Interest Account, the Principal Account, the Sinking Account and the Redemption Account. Under the Installment Purchase Agreement, the City will pay the Installment Payments out of the Sewer Revenue Fund to the Trustee for deposit into the Payment Fund so that the principal and interest due on the Series 1997 Bonds and the Outstanding Parity Bonds shall be paid no later than the last business day on which such payment is due. Subject to the provisions of the Indenture, all money in the Payment Fund will be deposited by the Trustee in the following respective special accounts within the Payment Fund in the following order of priority: (i) Interest Account, (ii) Principal Account, and (iii) Redemption Account.

Bond Insurance

The following information has been furnished by Financial Guaranty Insurance Company, doing business in California as FGIC Insurance Company ("Financial Guaranty") for use in this Official Statement. Reference is made to Appendix F for a specimen of Financial Guaranty's policy.

Concurrently with the issuance of the Series 1997 Bonds, Financial Guaranty will issue its Municipal Bond New Issue Insurance Policy for the Series 1997 Bonds (the "Policy"). The Policy unconditionally guarantees the payment of that portion of the principal or and interest on the Series 1997 Bonds which has become due for payment, but shall be unpaid by reason of nonpayment by the Authority. Financial Guaranty will make such payments to State Street Bank and Trust Company, N.A., or its successor as its agent (the "Fiscal Agent"), on the later of the date on which such principal and interest is due or on the business day next following the day on which Financial Guaranty shall have received telephonic or telegraphic notice, subsequently confirmed in writing, or written notice by registered or certified mail, from an owner of Series 1997 Bonds or the Trustee of the nonpayment of such amount by the Authority. The Fiscal Agent will disburse such amount due on any Series 1997 Bond to its owner upon receipt by the Fiscal Agent of evidence satisfactory to the Fiscal Agent of the owner's right to receive payment of the principal and interest due for payment and evidence, including any appropriate instruments of assignment, that all of such owner's rights to payment of such principal and interest shall be vested in Financial Guaranty. The term "nonpayment" in respect of a Series 1997 Bond includes any payment of principal or interest made to an owner of a Series 1997 Bond which has been recovered from such owner pursuant to the United States Bankruptcy Code by a trustee in bankruptcy in accordance with a final, nonappealable order of a court having competent jurisdiction.

The Policy is non-cancellable and the premium will be fully paid at the time of delivery of the Series 1997 Bonds. The Policy covers failure to pay principal of the Series 1997 Bonds on their respective stated maturity dates or dates on which the same shall have been duly called for mandatory sinking fund redemption, and not on any other date on which the Series 1997 Bonds may have been otherwise called for redemption, accelerated or advanced in maturity, and covers the failure to pay an installment of interest on the stated date for its payment.

Generally, in connection with its insurance of an issue of municipal securities, Financial Guaranty requires, among other things, (i) that it be granted the power to exercise any rights granted to the holders of such securities

upon the occurrence of an event of default, without the consent of such holders, and that such holders may not exercise such rights without Financial Guaranty's consent, in each case so long as Financial Guaranty has not failed to comply with its payment obligations under its insurance policy; and (ii) that any amendment or supplement to or other modification of the principal legal documents be subject to Financial Guaranty's consent. The specific rights, if any, granted to Financial Guaranty in connection with its insurance of the Series 1997 Bonds are set forth in the description of the principal legal documents appearing elsewhere in this Official Statement. Reference should be made as well to such description for a discussion of the circumstances, if any, under which the Authority is required to provide additional or substitute credit enhancement and related matters.

This Official Statement contains a section regarding the ratings assigned to the Series 1997 Bonds and references should be made to such section for a discussion of such ratings and the basis for their assignment to the Series 1997 Bonds.

The Policy is not covered by the Property/Casualty Insurance Security Fund specified in Article 76 of the New York Insurance Law.

Financial Guaranty is a wholly-owned subsidiary of FGIC Corporation (the "Corporation"), a Delaware holding company. The Corporation is a subsidiary of General Electric Capital Corporation ("GE Capital"). Neither the Corporation nor GE Capital is obligated to pay the debts of or the claims against Financial Guaranty. Financial Guaranty is a monoline financial guaranty insurer domiciled in the State of New York and subject to regulation by the State of New York Insurance Department. As of September 30, 1996, the total capital and surplus of Financial Guaranty was approximately \$1,097,600,190. Financial Guaranty prepares financial statements on the basis of both statutory accounting principles and generally accepted accounting principles. Copies of such financial statements may be obtained by writing to Financial Guaranty at 115 Broadway, New York, New York 10006, Attention: Communications Department (telephone number: (212-312-3000) or to the New York State Insurance Department at 160 West Broadway, 18th Floor, New York, New York 10013, Attention: Financial Condition Property/Casualty Bureau (telephone number: (212-602-0389).

Reserve Fund

A portion of the proceeds of the Series 1997 Bonds will be deposited in the Reserve Fund, which together with amounts currently on deposit in the Reserve Fund, will equal the Reserve Requirement. The Reserve Requirement is defined to be, as of any date of calculation, the least of (i) 10% of the proceeds of the Series 1997 Bonds and the Outstanding Parity Bonds, (ii) Maximum Annual Debt Service on the Series 1997 Bonds and the Outstanding Parity Bonds for the then current or any future fiscal year, or (iii) 125% of average Annual Debt Service on the Series 1997 Bonds and the Outstanding Parity Bonds.

At the option of the City, amounts required to be held in the Reserve Fund may be withdrawn, in whole or in part, upon the deposit of a Credit Facility with the Trustee, in a stated amount equal to the amounts so withdrawn, provided, among other things, that prior to the deposit of such Credit Facility, each of the rating agencies then rating the Series 1997 Bonds and the Outstanding Parity Bonds shall be notified of such proposed withdrawal and the deposit of such Credit Facility shall not result in a withdrawal or downgrading of any rating of the Series 1997 Bonds and the Outstanding Parity Bonds then in effect by each of the rating agencies then rating such Bonds. Any such withdrawal shall be transferred, at the election of the City, to the Acquisition Fund, to the Principal Account of the Payment Fund, to the Redemption Account of the Payment Fund or to a special account to be established for the payment of any fees in connection with obtaining such Credit Facility.

Outstanding Parity Bonds

The City has incurred Parity Obligations in connection with the Series 1995 Bonds and the Series 1993 Bonds issued by the Authority on December 13, 1995 and October 12, 1993, respectively, for the purpose of financing the costs of certain improvements relating to the Metropolitan System. The Series 1995 Bonds were issued in the original aggregate principal amount of \$350,000,000, all of which is currently outstanding. The Series 1993 Bonds were issued in the original aggregate principal amount of \$250,000,000, \$238,285,000 of which is currently outstanding.

Parity Obligations

The City may not create any Obligations the payments of which are senior or prior in right to the payment by the City of Parity Obligations. The City may at any time issue or create Parity Obligations, provided the City obtains or provides a certificate or certificates, prepared by the City or at the City's option by a Consultant, showing that:

(i) the Net System Revenues as shown by the books of the City for any consecutive 12-month period out of the 18 consecutive months ending immediately prior to the incurring of such other Parity Obligations shall have amounted to at least 1.20 times the Maximum Annual Debt Service on all Parity Obligations Outstanding during such period; and

(ii) the estimated Net System Revenues for the next 12 months following the date of issuance of such other Parity Obligations will be at least equal to 1.20 times the Maximum Annual Debt Service for all Parity Obligations which will be Outstanding immediately after the issuance of the proposed Parity Obligations.

For purposes of the computations to be made as described in clause (ii) above, the determination of the Net System Revenues may take into account any increases in rates and charges which relate to the Wastewater System and shall take into account any reduction in such rates and charges, which will, for purposes of the test described above in clause (ii), be effective during the fiscal year ending within the 12-month period for which such estimate is made; and may take into account an allowance for any estimated increase in such Net System Revenues from any revenue producing additions or improvements to or extensions of the Wastewater System, to be made with the proceeds of such additional indebtedness or with the proceeds of Parity Obligations previously issued, all in an amount equal to the estimated additional average annual Net System Revenues to be derived from such additions, improvements and extensions for the first 36-month period in which each addition, improvement or extension is respectively to be in operation, all as shown by such certificate of the City or a Consultant, as applicable; and, for the period contemplated by clause (ii), Maintenance and Operation Costs of the Wastewater System shall be deemed to be equal to such costs for the 12 consecutive months immediately prior to incurring such other Parity Obligations, but adjusted if deemed necessary, by the City or a Consultant, as applicable, for any increased Maintenance and Operations Costs of the Wastewater System which are, in the judgment of the City or a Consultant, as applicable, essential to maintaining and operating the Wastewater System and which will occur during the fiscal year ending within the period contemplated by clause (ii). The City has met the Parity Obligations test described above incident to issuance of the Series 1997 Bonds.

The certificate or certificates with respect to clause (ii) above shall not be required if, among other things, the Parity Obligations being issued are for the purpose of refunding (a) then Outstanding Parity Obligations if at the time of the issuance of such Parity Obligations a certificate of an Authorized City Representative shall be delivered showing that Debt Service in each fiscal year on all Parity Obligations Outstanding after the issuance of the refunding Parity Obligations will not exceed the Debt Service in each corresponding fiscal year on all Parity Obligations Outstanding prior to the issuance of such Parity Obligations; or (b) then Outstanding Balloon Indebtedness, Tender Indebtedness or Variable Rate Indebtedness, but only to the extent that the principal amount of the refunding Parity Obligations (without regard to amounts thereof which after issuance are to be accreted) does not exceed the principal amount of the Balloon Indebtedness, Tender Indebtedness or Variable Rate Indebtedness has been put, tendered to or otherwise purchased by a standby purchase or other liquidity facility relating to such Indebtedness. For additional information relating to the terms and conditions for the issuance of the Parity Obligations, see "APPENDIX C -DEFINITIONS OF CERTAIN TERMS" and "APPENDIX D - SUMMARY OF PRINCIPAL LEGAL DOCUMENTS."

Subordinated Obligations

The City may issue and incur Subordinated Obligations which are payable from Net System Revenues on a basis subordinate to the payment by the City of the Installment Payments so long as no Event of Default has occurred and is continuing and no event of default or Termination Event under any Qualified Swap Agreement has occurred and is continuing.

SPECIAL CONSIDERATIONS FOR BONDHOLDERS

Incident to the purchase of the Series 1997 Bonds, prospective investors should give special consideration to the following:

1. See "ACTIONS UNDER THE CLEAN WATER ACT - Relief from Secondary Treatment Requirements" for information regarding a five year waiver from secondary sewage treatment requirements which the City has received and the consequences of the waiver not being extended. If the waiver is not extended, it is possible that the City would be required to make substantial additional capital expenditures that are not currently contemplated by the Wastewater System Capital Improvement Program.

2. See "WASTEWATER SYSTEM FINANCIAL OPERATIONS - Impact of Proposition 218 on Sewer Service Rates and Charges" for information regarding Proposition 218, a recently enacted voter approved initiative measure. Among other things, Proposition 218 empowers voters to use the initiative process to reduce "rates and charges" and requires that any new or increase in property related rates and charges, which may include fees and charges of the Wastewater System, be subject to a majority protest requirement and requires that all property related rates and charges, which may also include fees and charges of the Wastewater System, meet certain criteria by July 1, 1997.

3. See "WASTEWATER SYSTEM - Metropolitan System Facilities" for information regarding the construction of the Metro Biosolids Center at the Miramar Naval Air Station leased to the City from the United States Navy to replace the sludge processing facilities currently located at Fiesta Island. If the City defaulted under the lease or in the event of a national or military emergency, the City would be obligated to vacate the Miramar Naval Air Station and relocate the Metro Biosolids Center elsewhere.

THE AUTHORITY

The Authority was established pursuant to a Joint Exercise of Powers Agreement, dated May 14, 1991, by and between the City and the Redevelopment Agency of the City. The Authority is intended as a financing vehicle for City facilities and projects.

WASTEWATER SYSTEM

The Wastewater System

The Wastewater System consists of the Municipal System, which is a municipal sewage collection system for the City's residents, and the Metropolitan System, which is a regional sewage collection, treatment and disposal system initiated in 1958 (and operational since 1963) to serve the City and various other public agencies including cities situated within common drainage areas. The Metropolitan System was designed to provide sufficient capacity to accommodate a regional population of 2,600,000. The City, as operator of the Metropolitan System, is the holder of the National Pollutant Discharge Elimination System ("NPDES") permit and is responsible for maintaining the discharge requirements required under Federal law. The Metropolitan System, as presently designed, provides advanced primary treatment of sewage at its Point Loma Wastewater Treatment Plant. See "ACTIONS UNDER THE CLEAN WATER ACT - Relief From Secondary Treatment Standards" for information regarding the waiver from secondary treatment standards of the Clean Water Act which the City has received.

The map which follows the Table of Contents of this Official Statement shows the sewer service area boundaries of the Wastewater System which covers approximately 450 square miles, including most of the City.

Wastewater System Management

The Metropolitan Wastewater Department (the "MWWD") manages the Metropolitan System and since July 1, 1996 also assumed control of the Municipal System. For the fiscal year ending June 30, 1997, the MWWD has a \$537 million budget and expects to employ approximately 845 employees.

The MWWD operates the Wastewater System with funds derived primarily from service charges which are deposited in the Sewer Revenue Fund. The Sewer Revenue Fund was established by amendment to the City Charter on November 8, 1960. Funds in the Sewer Revenue Fund are used for the operation, maintenance and capital improvement of the Municipal System and Metropolitan System.

Municipal System Facilities

The Municipal System is comprised of 2,528 miles of trunk and collector mains, 82 sewer pump stations and 14 storm water interceptor pump stations serving in excess of 240,000 customer accounts. On average, these accounts (of which 82% are single-family dwellings, 12% are multi-family dwellings, and the remaining 6% are commercial and industrial customers) generate 128 million gallons per day ("mgd") of wastewater which is conveyed by the Municipal System to the Metropolitan System for treatment and disposal. The Wastewater System Capital Improvement Program contemplates expenditures of \$360.1 million for Municipal System facilities during the seven fiscal years ending June 30, 2003. The proceeds of the Series 1997B Bonds will be used to finance improvements to the Municipal System. See "WASTEWATER SYSTEM CAPITAL IMPROVEMENT PROGRAM."

Metropolitan System Facilities

The current Metropolitan System infrastructure, with the exception of the South Metro interceptor, is located within the jurisdictional boundaries of the City and is concentrated along a kidney shaped corridor running from Mission Bay to the north, and along the perimeter of the San Diego Bay to the south. The map on the inside front cover of this Official Statement shows the geographic concentration of the Metropolitan System's infrastructure and identifies the major trunk lines which service the Participating Agencies. The Wastewater System Capital Improvement Program contemplates expenditures of \$560.2 million for Metropolitan System facilities during the seven fiscal years ending June 30, 2003. The proceeds of the Series 1997A Bonds will be used to finance improvements to the Metropolitan System. See "WASTEWATER SYSTEM CAPITAL IMPROVEMENT PROGRAM."

The Metropolitan System's infrastructure consists of one main wastewater treatment plant, an ocean outfall, a sludge drying facility, two pump stations and force mains and gravity flow interceptors. A brief description of the current facilities and their primary functions is provided below.

Point Loma Wastewater Treatment Plant. The Point Loma Wastewater Treatment Plant (the "Point Loma Plant") began operation in 1963. The site is part of the Fort Rosecrans military reservation and was acquired by the City from the U.S. Department of the Interior, Bureau of Land Management. From 1963 to 1985, the Point Loma Plant functioned as a primary treatment plant; gravity separation was used to reduce suspended solids levels by 60% prior to ocean discharge. In 1985, the Point Loma Plant was equipped to use chemical coagulants to achieve 75% suspended solids removal. In 1996, the Point Loma Plant achieved suspended solids removal rates in the 82-85% range through the use of enhanced chemical treatment.

The wastewater treatment process currently employed at the Point Loma Plant consists of advanced primary treatment and includes mechanical screening by which raw wastewater flows into the Point Loma Plant through five 15 millimeter mesh, mechanically self-cleaning traveling screens, the addition of chemical coagulants to enhance settling to achieve at least 80% removal of suspended solids, sedimentation, and sludge digestion. A digester gas utilization facility is also a part of the Point Loma Plant. Dewatering and disposal of sludge are provided off site. See "ACTIONS UNDER THE CLEAN WATER ACT - Relief From Secondary Treatment Requirements" for information regarding the waiver from the secondary treatment standards of the Clean Water Act which the City has received.

Several capital improvement projects have been completed at the Point Loma Plant to rehabilitate, modify and expand various components, and additional capital improvements are planned. In August 1994, a capital improvements master plan for the Point Loma Plant was approved that contemplates the build out of the facility to its maximum hydraulic capacity of 240 mgd. Ongoing capital improvements include construction of two new sedimentation basins for a total of twelve basins, construction of a new effluent channel to all of the sedimentation basins, repair and modernization of two of the six digesters, construction of a new sludge pumping station, two additional digesters, automation of process control facilities and restoration of the ocean outfall intake structure. Projects under design include upgrade of the headworks, odor control and grit removal facilities, modernization of two existing digesters, a new operations building, expansion of the gas utilization facility, a central boiler facility and expansion of the maintenance building. All of these proposed improvements are included in the Wastewater System Capital Improvement Program described herein. See "WASTEWATER SYSTEM CAPITAL IMPROVEMENT PROGRAM."

Point Loma Plant Ocean Outfall. The Point Loma Plant ocean outfall was constructed in 1963 to provide a method for disposal of all plant effluent. The original capacity of the 11,316-foot long, 108-inch diameter outfall has been estimated at 390 mgd under the original design configuration. The City commenced construction in 1992 of a 12,500-foot extension of the original outfall (the "Point Loma Plant Ocean Outfall Extension"). The Point Loma Plant Ocean Outfall Extension was completed in November 1993 resulting in a 4.5 mile long outfall discharging treated sewage effluent at a depth of 320 ft. of water. It is one of the longest, deepest ocean outfalls in the U.S. This project assisted the City in satisfying its NPDES permit requirements every day of calendar years 1995 and 1996. See "WASTEWATER SYSTEM CAPITAL IMPROVEMENT PROGRAM" for information regarding current improvements to the Point Loma Outfall.

Fiesta Island Sludge Drying Facilities; Metro Biosolids Center. A portion of Fiesta Island, located in Mission Bay, is currently utilized by the City for mechanical dewatering and air drying of sewage sludge. Since 1963, digested liquid sludge at 3% solids has been pumped from the Point Loma Plant through an 8 mile pipeline to Fiesta Island. At the facility, mechanical belt filter presses provide initial dewatering functions. Solar energy dries the sludge cake in open sand drying beds. When the sludge solids content reaches 50%, the dried sludge is transported off-site for either beneficial use or landfill disposal. The California Coastal Commission has directed that the City vacate its sludge drying facilities at Fiesta Island since the use of the island for sludge processing has been determined to be incompatible with its intended recreational use and is imposing mitigation charges on the City until the facilities are vacated. The charges were \$2 million per year from 1993 until 1994, until the California Coastal Commission reduced the charges to \$1.5 million per year as a result of the progress that has been made constructing the replacement facilities described below. These charges all have been paid from System Revenues to the City's Department of Parks and Recreation. The City plans to close the Fiesta Island facility in December 1997.

The City will complete the construction of replacement facilities in 1997 on a site at Miramar Naval Air Station (the "Metro Biosolids Center") which it leases from the United States Navy under a 50-year lease. The lease permits the Navy to terminate the lease during its term without the payment of any compensation to the City with cause or without cause only in the event of a national or military emergency. The overall capital budget for the replacement facilities to be located at the Miramar site is expected to be approximately \$238 million. If the lease were terminated during its term by the Navy, the City would be obliged to vacate the site and relocate this facility elsewhere. The existence of this facility is an essential part of the waiver from secondary treatment requirements received by the City described under the caption "ACTIONS UNDER THE CLEAN WATER ACT - Relief From Secondary Treatment Requirements."

The Metro Biosolids Center will perform the following two primary functions. It will digest biosolids generated at the North City Water Reclamation Plant and it will mechanically dewater biosolids from the North City Plant and the Point Loma Wastewater Treatment Plant. The Metro Biosolids Center will replace dewatering operations currently located on Fiesta Island which service the Point Loma Plant. A for-profit enterprise will operate a cogeneration facility at this site and the North City Reclamation Plant site. Under the agreement with the cogeneration operator, the City bears the risk of loss of the value of these facilities of the cogeneration operator should the City's lease with the Navy be terminated. At the option of the City, the value of the facilities is calculated as either a "stipulated purchase price" or as the "fair market value" of the facilities, as each of these

terms are defined in the agreement with the for-profit operator. The maximum amount of exposure to the City for the loss of these facilities is \$28 million, but such loss would only arise upon the occurrence of a default by the City or a national or military emergency sufficient to cause the Navy to terminate the lease. A sludge drying facility is also proposed to be located at the Metro Biosolids Center. The sludge drying facility may be undertaken by a for-profit enterprise to produce agricultural fertilizer pellets. Other beneficial use options such as composting and direct land application are being considered along with landfill disposal.

Pump Stations. The two pump stations began operation in 1963. The pumping facilities are in good condition, and all structures, including wet wells, are expected to last at least another 25 years. No major modifications or improvements are anticipated except for installation of additional new pumps and motors and overhauls of existing pumps and motors, as needed.

Interceptors. The Metropolitan System interceptors consist of two major branches, the South Branch and the North Branch, which meet at Pump Station No. 2. Interceptor capacities are normally adequate for current peak flow, but in the near future some interceptor sections may be subject to peak flows that exceed design capacities. Under the Wastewater System Capital Improvement Program, it is contemplated that expenditures of \$35.7 million remain be made for interceptors during the period ending June 30, 2003. Construction projects are currently underway to address these future capacity needs. See "WASTEWATER SYSTEM CAPITAL IMPROVEMENT PROGRAM - Capital Improvement Projects - Metropolitan System - Major Interceptors (North and South)" for a description of the proposed improvements to the interceptors.

Additional Contractual Capacity Through the Escondido Wastewater Treatment Plant

In addition to the Metropolitan System facilities described above, the City in 1972 entered into a sewage disposal agreement with the City of Escondido, whereby up to 5 mgd of sewage emanating from the Rancho Bernardo sewer service area of the City of San Diego, may be treated at Escondido's Hale Avenue treatment plant. This agreement runs for 50 years, and at the City's option may be extended for an unlimited number of ten year periods. The Escondido Wastewater Treatment Plant is not owned by the City and is not part of the Metropolitan System.

Historical Wastewater System Flow

Table 2 below shows total annual system flow through the Point Loma Plant and Escondido Plant.

Table 2
TOTAL ANNUAL WASTEWATER SYSTEM FLOW IN MILLION GALLONS

Fiscal Year Ended June 30	City Flow through Point Loma Plant	Participating Agency Flow through Point Loma Plant	City Flow through Escondido Plant	Total System Flow	Average MGD For The Year
1965	16,440	6,703	420	23,563	65
1970	19,950	9,658	709	30,317	83
1975	26,125	13,269	562	39,956	109
1980	36,708	17,572	944	55,224	151
1985	39,397	20,246	1,218	60,861	167
1990	48,628	20,836	1,405	70,869	194
1991	45,602	19,218	1,365	66,185	181
1992	46,030	18,115	1,177	65,322	179
1993	48,680	20,092	1,318	70,090	192
1994	45,043	19,111	1,310	65,464	179
1995	46,802	19,724	1,321	67,847	186
1996	46,848	19,115	1,325	67,288	184

For the fiscal year ended June 30, 1996, the Metropolitan System (180 mgd) and the Escondido Plant (4 mgd) on a daily basis treated and disposed of more than 184 million gallons of sewage per day generated by approximately 1.9 million residents and businesses within the Metropolitan System service area and the Rancho Bernardo service area.

The Participating Agencies and Sewage Disposal Agreements and Other Agreements

The Metropolitan System provides "wholesale" treatment services, including some sewage transport, treatment and disposal operations to other cities and districts pursuant to Sewage Disposal Agreements with such entities (the "Sewage Disposal Agreements"). The Cities of Chula Vista, Coronado, El Cajon, Imperial Beach, La Mesa and National City, and the Lemon Grove Sanitation District and the Spring Valley Sanitation District (the "Original Participating Agencies") entered into the Sewage Disposal Agreements in 1960. Subsequent to that time the City entered into Sewage Disposal Agreements with the Cities of Del Mar and Poway and the Lakeside/Alpine Sanitation District, the Otay Water District, the Padre Dam Municipal Water District and the Wintergardens Sewer Maintenance District (the "Later Participating Agencies"). The Original Participating Agencies and the Later Participating Agencies are collectively referred to as the "Participating Agencies." The Participating Agencies and the City are responsible for the "retail" collection operations within their respective jurisdictions. The Participating Agencies also transport collected sewage through large trunk lines to the Metropolitan System. The collection systems and many of the transport trunk lines are owned by the individual Participating Agencies. The City bills the Participating Agencies quarterly on the basis of budgeted estimates and sewage flows. In the following fiscal year, when actual costs and flows are known and apportioned to each Participating Agency, billing adjustments are made to correct for any under or over charges in the previous year.

Each Participating Agency is responsible for transporting raw sewage to the Metropolitan System for treatment and disposal. The operational and administrative responsibilities and obligations of the City and each Participating Agency are defined in the Sewage Disposal Agreements. Under the terms of the respective Sewage Disposal Agreements, each Participating Agency pays an Annual Capacity Charge for their respective leased shares of the capacity allocated in the Metropolitan System which is amortized over a 40 year term. In addition to the payment of the Annual Capacity Charge, the Participating Agencies pay for their proportionate share of the maintenance and operations expenses of the Metropolitan System. Each Participating Agency pays an amount equal to that proportion of the total maintenance and operations expenses which the actual amount of sewage received from the Participating Agency bears to the total quantity of sewage treated and disposed of by the Metropolitan System. Presently, the maintenance and operations costs are recovered on the basis of flows without consideration of strength of discharge.

The Sewage Disposal Agreements provide that all repairs, reconstruction and replacements to the Metropolitan System are part of the maintenance and operations costs allocated to the Participating Agencies. The Sewage Disposal Agreements also provide that the conveyance, treatment and disposal of all sewage received into the Metropolitan System must comply with all applicable laws, rules and regulations. The Sewage Disposal Agreements with the City of Poway, the Lakeside/Alpine Sanitation District, the Padre Dam Municipal Water District and the Wintergardens Sewer Maintenance District, require such Later Participating Agencies to pay their proportionate share of the cost of expanding the Point Loma Plant to a capacity of 234 mgd of advanced primary treatment. The Original Participating Agencies are not required to pay the costs of such expansion.

In 1991, a dispute arose between five of the Participating Agencies (Chula Vista, El Cajon, La Mesa, Imperial Beach and the Padre Dam Municipal Water District) and the City regarding these Participating Agencies paying a portion of the capital cost for the Metro Biosolids Center and the Point Loma Plant Ocean Outfall Extension. In addition, in March 1995, another dispute arose when the City began billing the Participating Agencies for their pro rata share of costs associated with water reclamation projects which were incurred on or after November 1, 1994. The City selected November 1, 1994, because the legislation allowing a waiver from the secondary treatment requirements of the Clean Water Act described under "ACTIONS UNDER THE CLEAN WATER ACT - Relief From Secondary Treatment Requirements" became effective on October 31, 1994. In July 1996, the City began negotiations to resolve the billing disputes with the Participating Agencies. On October 29, 1996, the managers of all Participating Agencies agreed upon the principles of understanding (the "Principles of Understanding"), a document which sets forth certain agreements between the City and the Participating Agencies associated with disputed sewer costs. The Principles of Understanding have been ratified by each of the governing bodies of the Participating Agencies. As an incentive to obtain full ratification, the City reinstituted credits to nine of the Participating Agencies who had previously rejected revised billings that included their pro rata share of costs associated with water reclamation. The value of these incentive credits is approximately \$6.2 million and the City expects to credit these amounts to the nine Participating Agencies against future billings.

The Principles of Understanding, among other things, provides that:

(1) A "Metro Commission" will be established to serve as an advisory body to the San Diego City Council. The City and each Participating Agency will appoint a representative to the Metro Commission. While the Metro Commission will have the opportunity to present its position to the San Diego City Council in written staff reports, the San Diego City Council will have the final decision as to the operation of the Metropolitan System.

(2) The Participating Agencies are responsible for paying their fair share of all Metropolitan System costs (including, but not limited to, capital improvements, operations and maintenance and debt service required to operate the Metropolitan System in compliance with all laws) based on their proportionate flow within the Metropolitan System, as discussed below under "*Maintenance and Operation Costs*." Furthermore, the Principles of Understanding provide that such proportional payment includes the costs of reclaimed water to the extent required by federal legislation in the Ocean Pollution Reduction Act of 1994. Accordingly, the Participating Agencies will pay their proportionate share of the costs of the Metropolitan System Capital Improvement Program including the capital costs associated with the expansion of the Point Loma Plant up to 234 mgd as well as the costs of any further expansion beyond 234 mgd and any water reclamation projects with the following exceptions: a) the Participating Agencies will pay their *proportionate share* of the following percentages of project costs (i) 55 % of the North Metro

Interceptor, (ii) 66% of the Point Loma Sedimentation Basins 9-10, (iii) 24% of the Point Loma Sedimentation Basins 11-12, and (iv) 29% of Pump Station #2 - Pumps 7-8.

(3) The City will consider the repurchase of excess capacity from any of the Participating Agencies. Any repurchase would be voluntary on the part of the City and the Participating Agencies. See "*Capacity Rights*" below. The City expects to purchase \$5.0 million worth of Participating Agencies' capacity in the South Bay Ocean Outfall.

(4) The City and the Participating Agencies will undertake a joint engineering study of the South Bay Water Reclamation Plant and related facilities, with a target completion date of June 1, 1997, to conduct an objective analysis of such projects, including alternatives, the need for the projects, sizing and timing of the projects. For more information regarding the South Bay Water Reclamation Plant project, see Table 4 and "WASTEWATER SYSTEM CAPITAL IMPROVEMENT PROGRAM."

(5) The Metropolitan System, including the Participating Agencies, will not pay for City right-of-way charges. For more information on the City's right-of-way charges, see "WASTEWATER SYSTEM FINANCIAL OPERATIONS - Management's Discussion and Analysis - *Operating Expenses*."

(6) The City and the Participating Agencies will begin negotiations on revisions to the Sewage Disposal Agreements, including negotiating extensions to the term of the Sewage Disposal Agreements for an additional twenty to forty years, and will develop such revisions by November 1, 1997. These provisions will effect the provisions of the Sewage Disposal Agreements discussed below.

Since the Principles of Understanding resolve the billing disputes that caused the Participating Agencies to pay their bills under protest, all of the Participating Agencies have withdrawn their protest and have affirmed that withdrawal in writing. The City Attorney believes that the written withdrawals will allow the full use of all payments received from the Participating Agencies as long as the Principles of Understanding are being adhered to.

Key provisions of the Sewage Disposal Agreements include:

Term of Sewage Disposal Agreements. The Sewage Disposal Agreements expire on August 31, 2003 for the Original Participating Agencies, and June 30, 2003 for the Later Participating Agencies. As discussed above, the term of the Sewage Disposal Agreements may be extended pursuant to the negotiations with the Participating Agencies in accordance with the Principles of Understanding.

Limitations on the Type and Condition of Sewage. Participating Agencies must meet discharge standards established by State and Federal statutes and City Ordinances. Enforcement responsibilities, however, are not specified.

Administration, Maintenance, and Operation. The City has responsibility for operating, maintaining and managing the Metropolitan System.

Maintenance and Operations Costs. Maintenance and operations costs are allocated between the City and the Participating Agencies based on flow and are payable quarterly.

Annual Capacity Charge. Participating Agencies are also allocated capital improvement and debt service costs based on the actual capital cost initially incurred by the City to construct the Metropolitan System, including all financing costs, amortized over the financing term. These payments are made annually in one installment.

New Construction. The City can propose additions or modifications to the existing Metropolitan System. Participating Agencies which use the new facilities must negotiate changes in charges or will be assessed a 42 predetermined rental fee and a proportionate share of maintenance and operations expenses.

Option to Extend. Each Participating Agency may, at its option, unilaterally extend the current service agreement for a period of ten years without the consent of the City. If a Participating Agency elects to extend its Sewage Disposal Agreement, such Participating Agency must give written notice to the City no earlier than eighteen months and no later than one year prior to the expiration date described above.

Reclamation of Water. The City has the exclusive right to reclaim water at its own expense. Any reclaimed water will be the property of the City. In the event the City voluntarily elects to reclaim water, the capital and operating costs of reclamation are solely of the City. As discussed above with respect to the Principles of Understanding, the City and the Participating Agencies agree that the proposed reclamation projects do not fall within these provisions and that the Participating Agencies will pay their proportional payment for capital and operating costs of water reclamation under the Sewage Disposal Agreements.

Capacity Rights. The City has also entered into sewage transportation agreements with several Participating Agencies. These sewage transportation agreements established the terms and conditions for sewage transportation from Participating Agency collections systems to the Metropolitan System through City owned trunk lines. These trunk lines are within the City's Municipal System and are also presently part of the Metropolitan System infrastructure. The agreements establish charges or rents for the conveyance of wastewater based on Participating Agency flow. The charges or rents paid by the Participating Agencies constitute a part of System Revenues. Transportation agreements are separate and distinct from the Sewage Disposal Agreements.

Capacity rights may be added, assigned, or transferred by or among Participating Agencies with the approval of the City as owner of the Metropolitan System and holder of all reserve or residual capacity. New participants may join the Metropolitan System if approved by the City and after notification to the other Participating Agencies.

For the fiscal year ended June 30, 1996, out of a total annual sewage flow of 65,963 million gallons, the total City flow through the Metropolitan System was 46,848 million gallons, or 71.02% of the total flow. This overall proportion of the flow from the City and from the Participating Agencies is expected to continue.

Participating Agencies in the Metropolitan System are listed in the following table, together with the estimated population, present capacity rights (in mgd), and the percentage of total capacity represented by the capacity rights. The communities and agencies served by the Wastewater System form the second largest integrated metropolitan area in the State surpassed only by the Los Angeles metropolitan area.

Table 3
METROPOLITAN SYSTEM
PARTICIPATING AGENCIES
Fiscal Year Ended June 30, 1996

<u>Participating Agencies</u>	<u>Estimated Population⁽¹⁾</u>	<u>Capacity Rights (in mgd)</u>	<u>% of Total Capacity</u>	<u>Flow (mgd)⁽⁴⁾</u>	<u>% of Total Flow</u>
City of Chula Vista ⁽²⁾	153,400	19.20	8.21	9.45	5.25
City of Coronado	29,300	3.00	1.28	2.53	1.41
City of Del Mar	5,200	0.80	0.34	0.67	.37
City of El Cajon	93,400	10.00	4.27	8.16	4.53
City of Imperial Beach	28,350	3.50	1.50	2.03	1.13
City of La Mesa	57,500	6.30	2.69	4.80	2.66
City of National City	54,900	7.10	3.04	3.28	1.82
City of Poway	46,150	5.00	2.14	2.89	1.60
Lakeside/Alpine Sanitation District ⁽³⁾	31,994	4.47	1.91	3.47	1.93
Lemon Grove Sanitation District	25,200	2.80	1.20	1.52	0.84
Otay Water District	28,000	1.20	0.51	0.56	0.31
Padre Dam Mun. Water District	127,903	6.22	2.66	3.56	1.97
Spring Valley Sanitation District	74,514	10.70	4.57	8.43	4.68
Wintergardens Sewer Maintenance District	<u>9,246</u>	<u>1.21</u>	<u>0.52</u>	<u>0.87</u>	<u>0.48</u>
SUBTOTAL	765,057	81.50	34.84	52.22	28.98
City of San Diego	1,202,500	152.42	65.16	128.00	71.02
TOTAL:	1,967,557	233.92	100.00	180.22	100.00

(1) Source: Participating Agencies and California Department of Finance.

(2) Includes Montgomery Sanitation District.

(3) A single meter serves the sanitation districts of Lakeside and Alpine.

(4) Average for fiscal year. Not adjusted for flows between individual Participating Agencies.

As the foregoing table illustrates, the Participating Agencies are currently not utilizing all of their capacity rights for sewage treatment and disposal.

WASTEWATER SYSTEM REGULATORY REQUIREMENTS

General

The Wastewater System is subject to regulations imposed by the Clean Water Act, Public Law 92-500 (the "Clean Water Act"). The regulatory requirements are administered by the United States Environmental Protection Agency (the "EPA"), the California State Water Resources Control Board (the "State Board") and the San Diego Regional Water Quality Control Board (the "Regional Board"). Regulations of these agencies deal primarily with the quality of effluent which may be discharged from the Point Loma Plant, the disposal of sludge generated by the Point Loma Plant, the discharge of pollutants into groundwater, and the nature of waste material (particularly industrial waste) discharged into the collection system. The Point Loma Plant functions as an advanced primary treatment plant under the Clean Water Act.

To comply with federally mandated effluent quality and disposal criteria, the City must operate its wastewater treatment facility according to discharge limitations and reporting requirements set forth in its NPDES discharge permits. On November 9, 1995, the City received from the EPA a waiver of the secondary treatment requirements based on the successful implementation of criteria required in the Ocean Pollution Reduction Act of

1994. See "ACTIONS UNDER THE CLEAN WATER ACT - Relief from Secondary Treatment Requirements." The NPDES permit has a five-year life and all conditions imposed by the permit are being successfully met.

To comply with other federal regulations concerning the discharge of waste materials into the Wastewater System, the City must administer and enforce industrial pretreatment limitation standards upon industrial users of the system. The City has had an industrial waste program in effect since the early 1970s. The City's industrial waste ordinance sets forth water quality standards that industrial users must meet and provides enforcement procedures for violators. The Industrial Waste Division of the MWWD is currently responsible for monitoring an average of 1,000 permitted industries located in the metropolitan service area. In addition, each Participating Agency is required to permit and monitor all industries within its respective service area. While each Participating Agency as a condition of its respective Sewage Disposal Agreement is required to comply with quality standards set by the City, the City, at the urging of the EPA, has required separate pretreatment agreements with each Participating Agency to ensure industrial pretreatment requirements. All Participating Agencies have entered into such pretreatment agreements.

As a condition of having received federal EPA grant funds under the Clean Water Act for the planning and construction of various improvements at its Point Loma Plant, the City is subject to additional regulatory requirements. Among the grant-related requirements are guidelines which must be followed concerning planning methodologies, design criteria, construction activities, and the operation, maintenance and financing of facilities. As another condition of its past receipt of federal grants, the City and the Participating Agencies must have approved sewer service charge structures. Such service charge structures require the recovery of annual operations, maintenance and replacement costs from users of the system in a proportionate manner according to the customer's level of use. Such factors as volume, infiltration/inflow, delivery flow rate, and strength of sewage are to be considered for determining proportionate use. Sewer service charge rates for all retail users are reviewed annually and established at a level necessary to generate sufficient revenues to recover the annual operations, maintenance and replacement costs. With the exception of the Participating Agencies which are charged rates purely based on flow, sewer service charge rates for users are established to recognize the volume and strength characteristics of wastewater contributed to the Wastewater System. The rate structure has been reviewed by the State Board and no grant funds or costs under grant funded programs have been disallowed based on the nature of the rate structures.

In addition to federal requirements, the City must also comply with water quality based effluent State requirements, otherwise known as the State Ocean Plan. The City believes that it is in compliance with the State Ocean Plan. Another State law concerned with control of water quality is the Porter-Cologne Water Quality Control Act of 1969, as amended. The Porter-Cologne Act directly addresses the problem of water reclamation and reuse. A declared policy of the law is that the people of the State have a primary interest in the development of facilities to reclaim wastewater to supplement existing surface and underground water supplies in order to meet their water requirements. The legislative intent was to undertake all possible development of water reclamation facilities to make reclaimed water available for use. The law requires the State Department of Health Services to establish statewide reclamation criteria for each type of use where such use involves public health. The City's proposed water reclamation projects are subject to the Porter-Cologne Act and are being designed in consultation with State officials to comply with its requirements.

Recent Compliance Actions and Other Litigation

On February 8, 1996, the Regional Board accepted a proposal offered by the City to resolve all outstanding enforcement and liability issues relating to alleged sewer overflows involving the Wastewater System and inadequate reporting of such events. Without admitting any liability for pending issues related to sewer overflows and reporting, the City agreed to a cash payment of \$350,000 and approximately one million dollars total in environmental credit projects extending over five years, from 1996 to 2001. This settlement resulted in a full satisfaction of all issues between the City and the Regional Board through the date of settlement. To date, all requirements of the settlement have been met and there are no pending complaints involving the City before the Regional Board.

In another action, the Surfrider Foundation filed a petition in Superior Court for a writ of mandate against the City on June 29, 1995. The petition alleges that the City did not comply with the California Environmental

Quality Act ("CEQA") when it prepared an environmental impact report for its involvement in the South Bay Ocean Outfall, an outfall from the international sewage treatment plant (the "International Wastewater Treatment Plant") being constructed by the International Boundary and Water Commission ("IBWC"). See "WASTEWATER SYSTEM CAPITAL IMPROVEMENT PROGRAM - Capital Improvement Projects" for information regarding the South Bay Ocean Outfall project and see "WASTEWATER SYSTEM FINANCIAL OPERATIONS - Operations and Maintenance for Tijuana Effluent" for more information regarding the International Wastewater Treatment Plant. The City has contracted to be the construction manager for the South Bay Ocean Outfall as well as to have a 39.9% ownership interest in the outfall. On March 18, 1996, the Superior Court denied the Surfrider's writ of mandate, ruling that the City "appropriately followed CEQA procedures." The Surfrider Foundation has appealed this ruling to the Fourth District Court of Appeal. While plaintiffs seek a new environmental impact report and costs of suit, no damages or penalties are alleged.

Furthermore, the City has received a notice from the Surfrider Foundation and the Sierra Club of their intent to bring a citizen's action for violation of the Clean Water Act based on the alleged improper operation of the International Wastewater Treatment Plant. The notice also names the U.S. Army Corps of Engineers, the State Board and the Regional Board as responsible parties. While the notice declares the plaintiffs' intention to sue, no complaint has been filed or served on the City. Moreover, while the City has 39.9% ownership interest in the South Bay Ocean Outfall, the City has no ownership or involvement in the International Wastewater Treatment Plant. For more information regarding the International Wastewater Treatment Plant, see "WASTEWATER SYSTEM FINANCIAL OPERATIONS - Operations and Maintenance Expenses for Tijuana Effluent."

Moreover, the City received a draft audit from the Office of the Inspector General of the EPA covering two City construction grants on the San Pasqual Aquatic Treatment Facility and construction of the South Bay Ocean Outfall, Phase 1. The draft audit represents the initial opinion of the Inspector General but expressly notes that the draft does not "necessarily represent the Final EPA position" on what costs are allowed or disallowed for reimbursement on the respective projects. Accordingly, the City is reviewing the draft audit. After reviewing the draft audit, the City Auditor and Comptroller and the City Attorney have determined the potential exposure, if any, to the Sewer Revenue Fund is approximately \$9.4 million. However, the City's documentation supporting all claimed costs is being prepared and will be filed within the provided comment period. There is no assurance that the documentation will result in a revised audit reducing the amount of the disallowance.

ACTIONS UNDER THE CLEAN WATER ACT

General

In 1972, Congress enacted the Clean Water Act, which among other things, directed the EPA to monitor and to regulate the discharge of pollution into navigable water ways and to enforce the requirement that all wastewater treatment plants in the nation provide full secondary treatment for sewage. In 1977, Congress amended the Clean Water Act to allow waivers of secondary treatment standards for certain ocean dischargers. The City's Point Loma Plant currently provides advanced primary treatment in accordance with a waiver granted under the Clean Water Act.

City Action under the Clean Water Act

In September 1979, the City submitted an application to the EPA for a waiver from the secondary treatment standards based upon the EPA's proposed waiver regulations. The EPA tentatively approved the City's waiver application in September 1981. A revised waiver application incorporating updated flow projections was submitted to the EPA in November 1983. However, in September 1986, the EPA reversed its tentative approval of the City's 1979 waiver application and tentatively denied the City's 1979 and 1983 applications. In February 1987, the City Council decided to discontinue its efforts to obtain a waiver.

Litigation and Proposed Consent Decree

In July 1988, the United States of America, acting through the Department of Justice and the EPA, and the State of California filed suit against the City in U.S. District Court for alleged violations of the Clean Water Act, its NPDES permit, sewer overflows, and alleged irregularities in the City's pretreatment program that regulates industrial waste. The plaintiffs sought injunctive relief and monetary damages for alleged effluent limit violations, failure to meet secondary treatment standards, past sewer spills, and pretreatment violations. The lawsuit was divided into a penalty proceeding and a remedies proceeding.

Penalty Proceeding. In the penalty proceeding, the District Court found the City in violation of the Clean Water Act as a result of deficiencies in its pretreatment program (control of industrial users), frequent spills from the collection system, and the absence of secondary treatment. In June 1991, the District Court imposed a penalty of \$3,000,000; \$500,000 was payable to the U.S. Treasury on entry of judgment, with the remaining \$2,500,000 to be satisfied by means of an optional credit project. This credit project consisted of enactment of an ordinance requiring water conservation fixtures on all new construction, resales and remodels of buildings combined with a rebate program for water conservation fixtures in the minimum amount of \$500,000 for each of five years. To date, no party has filed any action challenging the satisfaction of the penalty order.

The City has fully satisfied these penalties by paying the \$500,000 monetary fine and by enacting ordinances which establish the requisite rebate program and requiring the installation of water conserving plumbing fixtures in all new construction or upon property transfer or remodeling. The rebate program was properly funded for all five years of the Court's order, from June of 1991 to June of 1996. Although the rebate continues to be funded as a water conservation measure, there is no continuing court mandate since the court order has been satisfied.

Remedies Proceeding. Beginning in 1988, in order to settle the remedies aspect of the case, the City commenced the design of a plan to modify and enlarge the Metropolitan System to comply with the secondary treatment requirements of the Clean Water Act. The City further began discussions with the United States and the State of California to negotiate a Partial Consent Decree (the "Consent Decree"), which would resolve the City's obligations under the Clean Water Act to treat its effluent to secondary treatment standards. In October 1989, a program for full upgrade to secondary treatment was approved by the City. This proposal was called "Alternative IVa."

On January 30, 1990, the San Diego City Council approved the Consent Decree to accomplish the upgrade. The Consent Decree required construction of secondary treatment facilities (six water reclamation plants, one new secondary treatment plant and upgrade of the Point Loma Plant to secondary treatment capability), upgrade of the City's pretreatment of industrial waste program, spill reduction measures, and miscellaneous additional capital improvements. The costs of these improvements were estimated in 1992 to be approximately \$2.4 billion. The Consent Decree also required some improvements affecting only the Municipal System.

The Consent Decree was lodged with the District Court in January 1991. In June 1991, the District Court issued a memorandum decision and interim order deferring approval of the lodged Consent Decree on the following conditions: (i) all construction milestones of secondary treatment facilities set forth in the Consent Decree would be honored; (ii) a one year pilot test of the Point Loma Plant would be conducted in order to test various chemical enhancements to reduce suspended solids; and (iii) the City would complete and submit a water reuse master plan for water reclamation.

In May 1992, the City Council voted to request the District Court to revise its June 1991 interim order to permit a modified and reduced wastewater upgrade to eliminate five of six water reclamation plants and to preserve the Point Loma Plant at its existing level of advanced primary treatment. This proposal was called the "Consumers' Alternative."

In July 1992, the District Court agreed to modify its interim order provided that the City continue construction of a single water reclamation plant (the North City Water Reclamation Plant, which is expected to be completed and operating by June 1997), the Point Loma Plant Ocean Outfall Extension (which is now completed),

and certain Municipal System upgrades (which are expected to be completed in their entirety by December 1998). The Court, however, deferred the milestones of all projects not identified in the Consumers' Alternative. The United States and the State of California unsuccessfully challenged the District Court's interim order on appeal.

In February and March of 1994, the District Court heard testimony and arguments on the issue of whether the Consent Decree should be issued as a final order. The City opposed entry, contending that changed circumstances and the broad reach of the Consent Decree were not in the public interest. In March 1994, the Court ruled that the Consent Decree was not in the public interest and thereby rejected it. Since the upgrading and remedial requirements mandated by the Consent Decree were rejected, these would have to be determined by a revised decree or a trial to determine what remedial requirements would be required in order to bring the City into compliance with the Clean Water Act. As discussed below under "Relief From Secondary Treatment Requirements," on November 9, 1995, the EPA granted the City a waiver from secondary treatment requirements. As a result of obtaining this waiver, all causes of action regarding secondary treatment were resolved.

In order to resolve the remaining causes of action regarding sewerage overflows, in July 1994, the City submitted a revised proposed interim order (the "Interim Order") with the District Court. Several of the Participating Agencies filed objections with the Court regarding the Interim Order and the City's intention to bill them for costs associated with water reclamation. Specifically, the Participating Agencies asked the District Court to include in the Interim Order requirements which would prohibit the City from using the Interim Order to enforce provisions of their Sewage Disposal Agreements regarding billing for water reclamation. In August 1994, the District Court issued an Interim Order which, among other things, provided that the court did not intend that its order should alter the rights or obligations of any of the parties to the Sewage Disposal Agreements. From August 1994 to September 1996, the City provided regular status reports to the Court confirming that all elements of the Interim Order were being satisfied.

Since issuance of the Interim Order, all parties began working to resolve all remaining issues relating to the sewerage overflows in the form of a final order (the "Final Order") that would detail the remaining upgrades necessary to bring the Wastewater System in compliance with the Clean Water Act. On September 13, 1996, the City, the EPA and an intervener, the Sierra Club, presented a Final Order to the U.S. District Court that resolved all remaining issues. The Final Order as presented resolves all claims of the United States against the City for alleged violations for sewerage overflows of the Clean Water Act and constitutes a full and complete settlement of all outstanding claims for relief.

In the Final Order, in addition to the capital improvements listed in the Interim Order, the City also agreed to (i) provide a concrete sewer main replacement or rehabilitation program of at least 60 miles of concrete pipe by June 30, 2000, (ii) prepare a plan for rehabilitation or replacement of the remaining concrete pipe by March 30, 1998, (iii) prepare a sewer pump station and force main audit by June 30, 1997, (iv) expand its residential grease control education program by December 31, 1997, (v) improve information management on the collection system by June 30, 2000 and (vi) increase its root inhibitor allocation for 1997 and 1998 to \$300,000 per year. The Final Order requires construction of approximately 37% of the capital improvement projects described below under "WASTEWATER SYSTEM CAPITAL IMPROVEMENT PROGRAM."

All parties to the litigation have agreed to the Final Order and each party and their counsel have signed the Final Order. The Final Order was lodged with the federal court and now is undergoing a public comment period. Upon the completion of the public comment period, the parties will request entry of the Final Order. Once entered, the Final Order will be a court-ordered requirement to complete the wastewater upgrades listed therein. The Final Order does not require payment of any monetary damages.

Relief From Secondary Treatment Requirements

On October 31, 1994, the Clean Water Act was amended to permit the granting of waivers by the EPA from secondary treatment requirements for certain ocean discharge waste disposal systems such as the City's. The City filed an application with the EPA for a waiver in April 1995, and in August 1995 the EPA issued a tentative decision approving the waiver and a modified NPDES permit. On November 9, 1995, the EPA granted the City's request for a modified NPDES permit pursuant to a waiver. The permit incorporated both federal NPDES and State

wastewater discharge requirements, required the upgrade of the Point Loma Plant to meet these requirements and required the construction of water reclamation facilities capable of treating 45 mgd by the year 2010, all of which the Wastewater System Capital Improvement Program contemplates. The waiver does not in any way modify the Final Order or the Wastewater System Capital Improvement Program. The waiver has a term of five years ending November 9, 2000 and the City would need to apply for successive five-year extensions in order to continue to be exempt from the secondary treatment standards of the Clean Water Act. There is no assurance that the EPA will grant additional waivers.

Should the City be required at some future date to upgrade the Wastewater System to provide secondary treatment discharge of wastewater, the cost to provide that service would be substantial. This requirement would reduce the capacity of the Point Loma Plant from 234 mgd to 180 mgd and the Wastewater System would therefore be required to provide substantial additional capacity for the treatment of sewage. None of the costs for these upgrades are reflected in the projections contained under "FINANCIAL PROJECTIONS."

WASTEWATER SYSTEM CAPITAL IMPROVEMENT PROGRAM

General

The Wastewater System Capital Improvement Program contains projects to upgrade the Municipal System and Metropolitan System. All such projects are managed by the MWWD. Table 4 shows the total budget, amount expended through June 30, 1996, the remaining cost and the percentage completed for the projects contained in the Wastewater System Capital Improvement Program for the period July 1, 1996 through June 30, 2003.

Table 4
WASTEWATER SYSTEM CAPITAL IMPROVEMENT PROGRAM COSTS
(July 1, 1996 through June 30, 2003)

<u>Projects</u>	<u>Total Budget (In Millions)</u>	<u>Expended Through June 30, 1996 (In Millions)</u>	<u>Remaining Cost⁽¹⁾ (In Millions)</u>	<u>Percent Complete</u>
Metropolitan System Projects				
Metro Biosolids Processing Projects	\$329.6	\$223.4	\$106.2	68%
North City Water Reclamation Plant	189.3	174.9	14.4	92%
Point Loma Plant Upgrade	169.0	72.6	96.4	43%
Point Loma Outfall	68.2	64.2	4.0	94%
South Bay Projects				
Water Reclamation Plant	112.7	8.9	103.8	8%
Sewage Conveyance System	57.1	30.5	26.6	53%
Ocean Outfall	187.1	92.7	94.4	50%
Major Interceptors (North and South)	115.5	75.8	35.7	68%
Other Metropolitan System Projects	<u>175.5</u>	<u>96.8</u>	<u>78.7</u>	<u>55%</u>
Subtotal Metropolitan System Projects	1,404.0	839.8	560.2	60%
Municipal System Projects	N/A	N/A	<u>360.1</u>	N/A
Total			920.3	

⁽¹⁾ The dollar amounts in this column (a) reflect the remaining amounts in the budget as of July 1, 1996, (b) give effect to assumed rates of inflation during the period covered, and (c) reflect amounts expected to be set aside for outstanding contracts during the period indicated without regard to the timing of expenditure of such amounts.

⁽²⁾ The percentages in this column reflect the amounts spent on a project through June 30, 1996 compared to the total budget from origination of the project.

Capital Improvement Projects

1. *Metropolitan System*

Metro Biosolids Processing Projects. This project consists of the Metro Biosolids Center, FIRP Pump Station, FIRP Phase II Digested Sludge and Centrate Pipeline, North City Raw Sludge and Water Pipelines, and the Biosolids Demonstration Project. The recommended overall sludge management plan consists of sludge collection at each treatment plant, digestion at the Point Loma Plant of Point Loma Plant sludge and digestion of sludge for the reclamation plants at the Metro Biosolids Center. Digested sludge from the Point Loma Plant and undigested sludge from the North City Water Reclamation Plant will be pumped to the Metro Biosolids Center. A for-profit enterprise will operate a cogeneration facility at the Metro Biosolids Center. A sludge drying facility is also proposed to be located at the Metro Biosolids Center. The sludge drying facility may be operated by a for-profit contractor to produce agricultural fertilizer pellets to be sold by the contractor. Other beneficial use options such as composting and direct land application are being considered and/or co-disposal in permitted solid waste landfills. Energy to operate the Metro Biosolids Center is currently planned to be provided using methane gas. The Metro Biosolids Center will be located at Miramar Naval Air Station, north of the City, under a lease from the U.S. Navy to the City.

North City Water Reclamation Plant. This facility is scheduled to begin operating by June 1997. The process includes screening, grit removal, settling, flow equalization, activated sludge processing, tertiary filtration and effluent disinfection. Support facilities include an administration building, operation and maintenance building and chemical building. The 30 mgd capacity of the facility will be achieved by June 1997. The reclaimed water generated by the plant will be distributed to users through a reclaimed water distribution system that is being financed by the City's Water Fund.

Point Loma Plant Upgrade. Under the Wastewater System Capital Improvement Program, an ultimate capacity of 240 mgd average annual daily flow at the Point Loma Plant is envisioned using the chemically assisted advanced primary treatment process. Sludge digestion will be performed on-site with digested sludge being conveyed to the Metro Biosolids Center for dewatering. Expansion of the Point Loma Plant is being implemented through construction of a series of projects that will not significantly disrupt wastewater flow during the construction period.

Point Loma Outfall. Additional ballast is being provided to support the older portion of the Point Loma Outfall.

South Bay Water Reclamation Plant. This facility is planned to be completed by the year 2000 and will have a 7 mgd capacity. Reclaimed water produced by the plant will be conveyed through reclaimed water distribution pipelines to reuse markets in the South Bay. These reclaimed water pipelines will be financed by the City's Water Fund. Adding a further 8 mgd of capacity to this plant is one of the system-wide options available to the MWWD in order to meet the 45 mgd total water reclamation system capacity by the year 2010 as required by the waiver described above under "ACTIONS UNDER THE CLEAN WATER ACT - Relief From Secondary Treatment Requirements." Access to and from the plant will be provided by construction of a bridge spanning the Tijuana River which will be financed as part of the facility. See "WASTEWATER SYSTEM - The Participating Agencies and Sewage Disposal Agreements and Other Agreements" for more information regarding a joint engineering study by the City and the Participating Agencies of the project to evaluate, among other things, the schedule for this project.

South Bay Sewer Conveyance System. A pump station, force main and associated sewer pipelines will be constructed to convey wastewater to the South Bay Water Reclamation Plant.

South Bay Ocean Outfall. An outfall running seaward from the Tijuana River Estuary is being constructed under the auspices of the IBWC. The City has contracted to be the construction manager for the South Bay Outfall and will have a 39.9% ownership interest in the outfall. The City is sharing the costs of the project based upon its peak flow requirements as a portion of the total peak flow capacity of the outfall. The outfall has a peak flow capacity of 333 mgd. The City's portion is 133 mgd. The anticipated completion date for this project is June 1998.

Major Interceptors (North and South). The South Metro Interceptor is being upgraded to extend its useful life by the installation of a liner system. The North Metro Interceptor project consists of construction to increase the capacity of the pipeline from 153 mgd to 318 mgd. The North and South Metro Interceptors converge at a pump station from which sewage is pumped via two force mains to the Point Loma Plant. The two force mains are being modified so that they may be isolated from each other to facilitate inspection and repair.

Other Metropolitan System Projects. The MWWD continues to develop COMNET, a system-wide standardized means of providing the Metropolitan System with process control and monitoring. COMNET includes plant support as well as system communications. Additionally, the MWWD continues to investigate various wastewater treatment technologies and utilize specialized engineering support to plan for the future and to maximize the cost effectiveness of the overall system configuration. Construction management services contracts and an owner controlled insurance program are also supported.

2. *Municipal System*

The rehabilitation and expansion of the Municipal System is included in the Wastewater System Capital Improvement Program. The projects include the replacement of deteriorated concrete sewer collector lines, rehabilitation of sewer pumping stations and construction of new interceptor lines and pump stations as described

below. In addition, infrastructure of the Wastewater System Capital Improvement Program for the Municipal System also includes those projects required in the Final Order. The estimated cost of the projects governed by the Final Order is \$60 million.

Annual Allocations (\$247.5 million-total over period ending June 30, 2003). Annual allocations are included in a capital budget each year to cover projects that are not identified until after the beginning of the budget year. Annual allocations provide for as-needed consultant services, relocation of sewer lines as necessitated by the California Department of Transportation Highway Construction Program, replacement of sewer mains which may be deteriorated or under-sized, and replacement of deteriorated pumping equipment and/or appurtenances. Specific projects are identified on an as-needed, priority basis.

Trunk and Interceptor Sewer Projects (\$84.5 million). These projects are for the replacement, rehabilitation, expansion or construction of existing sewer lines and new sewer lines. These projects are specifically identified in advance of budget adoption and typically are larger and more expensive than projects funded through the annual allocations described above.

San Pasqual Aquatic Treatment Facility - Phase II (\$15.4 million). Phase I of this project consisted of a water reclamation plant. It was jointly funded by the Water Fund and the Sewer Revenue Fund. The reclaimed water produced by this plant is currently being used by various customers for irrigation purposes. Phase II, also jointly funded by the Water Fund and the Sewer Revenue Fund, will provide an additional use of the reclaimed water of the plant to recharge the San Pasqual ground water basin. The source of the sewage treated in this facility is from the Rancho Bernardo community.

Pump Station Projects (\$10.4 million). These projects are for the replacement, expansion or construction of existing sewer pump stations and new sewer pump stations. These projects are specifically identified in advance of budget adoption and typically are larger and more expensive than projects accomplished through the annual allocations.

Telemetry Control System (\$2.3 million). This project provides for a centralized, automated monitoring and control facility for the Wastewater System. The new telemetry control system will upgrade and centralize all telemetry system controls into one location to facilitate the tracking of data.

Contract Disputes

From time to time, the City is engaged in disputes with contractors and subcontractors working on the Wastewater System Capital Improvement Program. Currently, there are a number of pending contract disputes with vendors or contractors that claim an aggregate amount of \$7,000,000.

CAPITAL IMPROVEMENT FINANCING PLAN

The projected Wastewater System Capital Improvement Program is funded by a combination of financing from Net System Revenues and debt financing. Table 5 summarizes the actual sources and uses of funds for the Wastewater System Capital Improvement Program for the fiscal year ended June 30, 1996 and the projected sources and uses of funds for the Wastewater System Capital Improvement Program for the fiscal years ending June 30, 1997 through June 30, 2003. The Wastewater System Capital Improvement Program includes the costs of the projects described in Table 4. If the City is obligated to provide secondary treatment at the Point Loma Plant, the capital costs of the Wastewater System Capital Improvement Program could be substantially increased. See "SPECIAL CONSIDERATIONS FOR BONDHOLDERS."

Table 5 also gives effect to the financial assumptions contained under the heading "FINANCIAL PROJECTIONS - Projected Operating Results."

Table 5
SOURCES AND USES OF FUNDS FOR CAPITAL EXPENDITURES
WASTEWATER SYSTEM CAPITAL IMPROVEMENT PROGRAM
(In Thousands of Dollars)
Fiscal Years Ending June 30, 1997 to 2003

	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>Total⁽³⁾</u>	<u>1996</u> <u>(Actual)⁽⁴⁾</u> <u>Unaudited</u>
SOURCE OF FUNDS									
Beginning Balance of Construction Fund	\$155,268	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$155,268	\$ 13,380
New Bond Issues	250,000	161,092 ⁽⁵⁾	179,103	79,543	0	0	0	669,738	350,000
Grant Receipts	27,909	9,695	0	0	0	0	0	37,604	33,691
Contributions in Aid	50,972	19,611	8,427	0	0	0	0	79,010	14,693
Pay-as-You-Go	<u>24,769</u>	<u>25,051</u>	<u>23,043</u>	<u>6,776</u>	<u>70,573</u>	<u>52,473</u>	<u>61,232</u>	<u>263,917</u>	<u>77,838</u>
TOTAL SOURCES	\$508,918	\$215,449	\$210,573	\$ 86,319	\$ 70,573	\$ 52,473	\$61,232	\$1,205,573	\$489,602
USES OF FUNDS									
Issue Costs	\$ 3,127	\$ 2,013	\$ 2,239	\$ 995	\$ 0	\$ 0	\$ 0	\$ 8,374	\$ 8,956
Debt Service Reserve Fund	19,144	12,336	13,715	6,091	0	0	0	51,286	22,961
Reimbursement of Prior Capital Expenditures	0	0	0	0	0	0	0	0	14,157
Contribution to Construction Fund	0	0	0	0	0	0	0	0	155,268
Capital Expenditures ^{(1) (2)}	<u>486,648</u>	<u>201,099</u>	<u>194,619</u>	<u>79,234</u>	<u>70,573</u>	<u>52,473</u>	<u>61,232</u>	<u>1,145,878</u>	<u>288,260</u>
TOTAL USES	\$508,918	\$215,448	\$210,573	\$ 86,320	\$ 70,573	\$52,473	\$61,232	\$1,205,537	\$489,602
(1) Capital Expenditures by System								Total	1996 (Actual)
Municipal System	73,128	39,357	54,934	45,614	52,674	50,042	58,427	374,176	48,514
Metropolitan System	<u>413,520</u>	<u>161,743</u>	<u>139,685</u>	<u>33,620</u>	<u>17,899</u>	<u>2,431</u>	<u>2,805</u>	<u>771,703</u>	<u>239,746</u>
Total System	\$486,648	\$201,100	\$194,619	\$ 79,234	\$ 70,573	\$52,473	\$61,232	\$1,145,879	\$288,260

- (2) Projected amounts to be set aside during this period for contracts for the Wastewater System Capital Improvement Program aggregate approximately \$920.3 billion. See Table 4. Table 5 describes projected cash expenditures for Wastewater System Capital Improvement Program projects rather than projected set asides.
- (3) Reflects total of projected sources and uses for fiscal years ending June 30, 1997 through June 30, 2003.
- (4) Included to comply with the Continuing Disclosure Agreement entered into in connection with the issuance of the Series 1995 Bonds.
- (5) See "FINANCIAL PROJECTIONS" regarding the possible use of borrowings under the State Revolving Fund Program.

WASTEWATER SYSTEM FINANCIAL OPERATIONS

The City's primary sources of moneys deposited in the Sewer Revenue Fund are derived from sewer service charges to City residents and commercial enterprises, capacity charges on new, additional or larger connections to the Wastewater System within the City, revenues from the Participating Agencies pursuant to the Sewage Disposal Agreements and interest income on fund balances.

Establishment, Calculation and Collection of Sewer Service Charges

Sewer service charges to City utility customers, which are collected with municipal water bills and enforceable by discontinuance of water service, have been collected by the City since 1956. Periodically, sewer service charges have been revised, the latest revision becoming effective October 2, 1996.

The City has dedicated personnel and resources to analyze rates and charges necessary to support the Wastewater System. They are responsible for collecting and collating revenue and expenditure data from key administrative, engineering, financial and budgetary City departments, then evaluating the adequacy of revenues and recommending rate adjustments in concert with debt size and timing. Once projected revenues and expenditures are validated, financing options are evaluated for the optimal mix of internally generated revenue and debt. This process, conducted biannually for management purposes and as required to facilitate planned debt issuances and rate adjustments, involves an extensive technical review by a multi-departmental finance team and detailed oversight from a senior management executive committee comprised of the City Manager, Auditor/Comptroller, Financial Management Director, the Water Department Manager, the MWWDD Director, and Deputy City Attorney. After final review and validation, a financing plan is presented to the City Council for consideration, incorporating near-term debt and rate considerations as specific recommendations. See "City Council Actions Relating to Rate Changes."

Sewer service charges are based on the characteristics (volume of sewage, or flow, and suspended solids, or strength) of the wastewater discharged by each particular sewer user. All sewer users are charged based upon the amount of flow and solids which they discharge into the Wastewater System. As sewage discharge is not metered, water sales are used to approximate each customer's sewage flow. Suspended solids are based upon the classification of the user, determined by site inspections and/or analyses as required or requested.

Single-family residential customers are billed based on average winter months' water usage. The monthly service charge for this customer type is set on July 1 of each year, based upon the individual customer's average water consumption during the previous winter months when the local area normally receives most of its annual rainfall and irrigation needs are minimized. Once set, the customer's monthly sewer service charge is fixed until the next July 1. For the fiscal year ending June 30, 1997, the minimum charge is a base fee of \$7.14 per month, and the maximum charge, including the base fee, is \$28.54 per month.

The historical sources of sewer service revenues of the Sewer Revenue Fund for the fiscal years ended June 30, 1992-96, are set forth in Table 6 below.

Table 6
HISTORICAL SOURCES OF SEWER SERVICE REVENUES⁽¹⁾
(In Thousands of Dollars)
Fiscal Years Ended June 30, 1992 to 1996
(Unaudited)

<u>Source</u>	<u>1992</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>
Single Family Domestic . .	\$44,120	\$48,639	\$53,213	\$56,550	\$56,502
Other Domestic	30,476	34,520	36,416	38,784	39,609
Commercial	25,512	29,749	28,299	30,660	30,957
Industrial	6,953	5,266	5,733	7,173	7,504
Outside City	7	6	8	9	10
Treatment Plant Service for Others ⁽²⁾	<u>28,881⁽³⁾</u>	<u>26,986⁽³⁾</u>	<u>32,360</u>	<u>32,271⁽³⁾⁽⁴⁾</u>	<u>32,921⁽⁴⁾</u>
TOTAL	\$135,949	\$145,166	\$156,029	\$165,447	\$134,582

-
- (1) Does not include capacity charges or other operating revenues which are included in calculating Net System Revenues.
(2) Includes revenues from Participating Agencies, the United States Navy and other agencies.
(3) Reflects retroactive billings for costs of the Wastewater System Capital Improvement Program.
(4) Certain Participating Agencies were making a portion of their payments under protest or pursuant to a court order. None of the amounts which were paid under protest or pursuant to a court order were taken into income for fiscal years 1995 or 1996.

The ten largest customers of the Municipal System, as measured by the fiscal year ended June 30, 1996 billings, are estimated to have accounted for approximately 10.47% of the Sewer Revenue Fund's total revenues for that fiscal year. Table 7 shows the billings for these customers and the related percentages of total revenues for the Sewer Revenue Fund.

Table 7
TEN LARGEST CUSTOMERS WITHIN MUNICIPAL SYSTEM⁽¹⁾
Fiscal Year Ended June 30, 1996
(Unaudited)

	<u>Billings</u>	<u>Percent of Total Sewer Fund Revenues⁽²⁾</u>
United States Navy	\$ 8,543,581	5.10 %
Kelco	3,914,441	2.34
University of California, San Diego	1,530,913	0.91
R.J. Donovan Prison	751,475	0.45
City of San Diego	713,419	0.43
San Diego Unified School District	557,290	0.33
SONY	508,402	0.30
San Diego Zoo	383,711	0.23
Marine Park (Sea World)	341,949	0.20
Federal Government	<u>302,524</u>	<u>0.18</u>
 TOTAL	 \$17,547,705	 10.47 %

-
- (1) Does not include Participating Agencies or customers served by Participating Agencies.
(2) Total Sewer Revenue Fund Revenues includes receipts from Participating Agencies.

Set forth below as Table 8 is a six-year rate history for sewage service charges.

Table 8
SIX-YEAR RATE HISTORY
FOR SINGLE FAMILY RESIDENTIAL UNITS
AND COMMERCIAL & INDUSTRIAL

<u>Effective Date</u>	<u>Single Family Domestic</u>	<u>% Increase for Single Family Domestic Rates</u>	<u>Other Domestic, Commercial & Industrial⁽¹⁾ (Monthly Charge)</u>	<u>% Increase for Other Domestic, Commercial & Industrial Rates</u>
July 1, 1991	19.24	6.0%	0.34 plus SS Charge of \$1.107 to \$2.254 per Hcf	6.0%
July 1, 1992	20.39	6.0%	0.36 plus SS Charge of \$1.173 to \$2.389 per Hcf	6.0%
July 1, 1993	21.61 ⁽²⁾	6.0%	0.38 plus SS Charge of \$1.243 to \$2.532 per Hcf	6.0%
July 1, 1994	22.91	6.0%	0.40 plus SS Charge of \$1.318 to \$2.684 per Hcf	6.0%
July 1, 1995	22.91	0%	0.40 plus SS Charge of \$1.318 to \$2.684 per Hcf	0%
October 2, 1996 ⁽³⁾	24.28	6.0%	0.42 plus SS Charge of \$1.397 to \$2.845 per Hcf	6.0%

- (1) Other domestic, commercial and industrial monthly charges are based upon volume of flow and suspended solids. Charges range from the current base fee of \$0.40 per month to several hundred thousand dollars.
- (2) In this fiscal year, the City began sewer billings based on an average winter months' water usage. Previously, the City billed for sewer usage on a fixed flat fee. The percentage increase for the fiscal years beginning July 1, 1993 and thereafter represent estimated average increases.
- (3) On the same date, the City Council also approved an additional 6% rate increase in single family domestic rates and in other domestic, commercial and industrial rates effective July 1, 1997.

Accounts Receivable

Billing is done primarily on a bi-monthly basis. Typically, the City seeks to collect unpaid bills by (i) issuing an initial shut-off notice as early as 30 days after a bill is issued, (ii) issuing a final shut-off notice as early as 45 days after a bill is issued, and (iii) shutting off the customer's water service as early as 50 days after a bill is issued. This procedure results in almost all past due bills being paid. If necessary, the City establishes time payments for customers who are unable to pay a past due amount. If an account is closed with an amount due which remains unpaid, that account is referred to the City Treasurer for collection activities. An allowance is taken each fiscal year for accounts receivable which are not expected to be paid. During the five fiscal years ended June 30, 1996, this amount ranged from \$378,324 for the fiscal year ended June 30, 1992 to \$851,257 for the fiscal year ended June 30, 1996.

Table 9 sets forth information related to accounts receivable and number of shut-offs.

Table 9
SEWER CUSTOMER ACCOUNTS RECEIVABLE
AND SHUT-OFFS BY FISCAL YEAR
(In Thousands of Dollars)
For Fiscal Years Ended June 30, 1992 to 1996

(Unaudited)

	<u>1992</u>	<u>1993</u>	<u>1994</u>	<u>1995⁽²⁾</u>	<u>1996</u>
Sewer Service Revenue ⁽¹⁾	\$135,949	\$145,165	\$157,070	\$165,447	\$167,505
Accounts Receivable ⁽²⁾⁽³⁾	\$ 8,865	\$ 10,459	\$ 10,632	\$ 9,859	\$ 11,016
Accounts Receivable Over 120 Days ⁽³⁾	\$ 561	\$ 540	\$ 730	\$ 1,076	\$ 1,064
No. of Shut-Offs ⁽¹⁾	16,677	17,152	16,738	14,983	13,915

(1) For the year ended June 30.

(2) Excludes amounts payable by Participating Agencies.

(3) As of June 30.

City Council Actions Relating to Rate Changes

Effective July 1990, the City Council adopted a five-year revenue plan which established rate increases of 6% per year for monthly sewer rates, and 16% per year for capacity charges. On October 2, 1996, the City Council adopted 6% rate increases effective for each of the fiscal years ending June 30, 1997 and June 30, 1998. The financial projections for the Wastewater System Capital Improvement Program reflect such increases, as well as increases in later years. See "FINANCIAL PROJECTIONS." In addition, the City is required to fix rates for the Wastewater System such that charges for wastewater services will be at least equal to pay all outstanding Obligations (other than Parity Obligations) and to provide Net System Revenues equal to 120% of Debt Service for the year. See "SECURITY FOR THE SERIES 1997 BONDS - Rate Covenant; Impact of Proposition 218." However, for information on the possible limitation on the City's ability to comply with the rate covenant, see "WASTEWATER SYSTEM FINANCIAL OPERATIONS - Impact of Proposition 218 on Sewer Service Rates and Charges."

Collection and Calculation of Capacity Charges

A capacity charge is a one-time fee for a new, additional or larger connection to the Municipal System within the City. Capacity fees are not treated as operating income for financial reporting purposes but are considered System Revenues and are deposited in the Sewer Revenue Fund. Pursuant to California law, capacity fees are applied only to capital expansion, bonds, contracts, or other indebtedness of the Wastewater System related to expansion. Because capacity fees are primarily collected on new construction within the City, revenues obtained on such fees vary based upon construction activity and, reflecting a slow down in residential construction and due to the decrease in capacity charges discussed below, the City's financing plan contemplates a significantly reduced level of capacity charge revenues when compared to the Official Statement, dated December 6, 1995, relating to the Series 1995 Bonds (the "Prior Official Statement"). See "FINANCIAL PROJECTIONS." Historical capacity charge revenues and equivalent dwelling units ("EDU") are shown in Table 10 below. Capacity charges are shown in Table 11.

Table 10
SEWER REVENUE FUND
HISTORICAL CAPACITY CHARGE REVENUES

Fiscal Year Ended June 30	Equivalent Dwelling Units⁽¹⁾	Capacity Charge Revenues⁽²⁾
1986	15,460	\$15,093,242
1987	14,883	\$16,975,047
1988	6,830	\$10,736,525
1989	13,157	\$21,920,230
1990	6,489	\$22,252,058
1991	2,757	\$10,657,003
1992	2,762	\$12,385,388
1993	2,100	\$10,920,494
1994	2,509	\$15,136,994
1995	1,625	\$11,368,587
1996	2,861	\$12,526,955 ⁽³⁾

(1) Unaudited.

(2) Audited, except for fiscal year ended June 30, 1996.

(3) Reflects retroactive reduction in capacity charges.

Table 11
SIX-YEAR RATE HISTORY
FOR SEWER CAPACITY CHARGES

Effective Date	Sewer Capacity Charges (Per Unit)	%Increase (Decrease)
July 1, 1991	\$4,484	16 %
July 1, 1992	\$5,201	16 %
July 1, 1993	\$6,033	16 %
July 1, 1994	\$6,998	16 %
July 1, 1995	\$6,998	0 %
April 22, 1996	\$2,500	(64 %)

In response to a request by the City Manager to reduce sewer capacity charges in order to stimulate economic development and affordable housing, the City Council approved in June 1996, retroactive to April 22, 1996, a 64% reduction of sewer capacity charges. If Proposition 218 is determined to apply to sewer capacity charges and other sewer fees and charges and if such capacity charges are found to be below the cost of providing the service, these and other fees and charges of the Wastewater System may need to be revised in order to satisfy the requirements of Proposition 218. See "Impact of Proposition 218 on Sewer Service Rates and Charges."

Impact of Proposition 218 on Sewer Service Rates and Charges

On November 5, 1996, the voters of the State approved Proposition 218, the so-called "Right to Vote on Taxes Act." Proposition 218 added Articles XIIC and XIID to the State Constitution, which contain a number of provisions affecting the ability of the local governments to levy and collect both existing and future taxes, assessments, fees and charges.

Article XIID conditions the imposition or increase of any "fee" or "charge" upon there being no written majority protest after a required public hearing and, for fees and charges other than for sewer, water or refuse collection services, voter approval. Article XIID defines "fee" or "charge" to mean levies (other than ad valorem or special taxes or assessments) imposed by a local government upon a parcel or upon a person as an incident of the ownership or tenancy of real property, including a user fee or charge for a "property-related service." It is not clear whether Article XIID applies to the City's sewer service fees and charges, which are the ultimate source of Revenues pledged to debt service on the Series 1997 Bonds and the Outstanding Parity Bonds.

In addition, by July 1, 1997, under Article XIID, all property related fees and charges, including those which have been in existence since prior to the passage of Proposition 218 in November 1996, must meet the following substantive standards:

- (1) Revenues derived from the fee or charge cannot exceed the funds required to provide the property related service.
- (2) Revenues derived from the fee or charge must not be used for any purpose other than that for which the fee or charge was imposed.
- (3) The amount of a fee or charge imposed upon any parcel or person as an incident of property ownership must not exceed the proportional cost of the service attributable to the parcel.
- (4) No fee or charge may be imposed for a service unless that service is actually used by, or immediately available to, the owner of the property in question. Fees or charges based on potential or future use of a service are not permitted. Standby charges, whether characterized as charges or assessments, must be classified as assessments and cannot be imposed without compliance with Section 4 of Article XIID (relating to assessments).
- (5) No fee or charge may be imposed for general governmental services including, but not limited to, police, fire, ambulance or library services where the service is available to the public at large in substantially the same manner as it is to property owners.

Without conceding that its sewer rates and charges are subject to Article XIID, the City has undertaken an analysis of its sewer rates and charges which it expects to complete prior to July 1, 1997 and, if necessary, it will make appropriate adjustments to such rates and charges, subject to the possible application of Article XIID if any of those rates or charges must be increased. It is unclear whether under the foregoing standards rates and charges may be established at levels which would permit deposits to a Rate Stabilization Fund or maintenance of uncommitted cash reserves. See paragraph 4 under the heading "FINANCIAL PROJECTIONS - Projected Operating Results."

Article XIIC removes limitations on the initiative power in matters of local taxes, assessments, fees and charges. Consequently, the voters of the City could, by future initiative, repeal, reduce or prohibit the future imposition or increase of any local tax, assessment, fee or charge. "Assessment," "fee" and "charge" are not defined in Article XIIC and it is unclear whether the definitions of such terms contained in Article XIID (which are generally property-related as described above) are so limited under Article XIIC. No assurance can be given that the voters of the City will not, in the future, approve initiatives which repeal, reduce or prohibit the future imposition or increase of assessments, fees or charges, including the City's sewer service fees and charges, which are the source of Net System Revenues pledged to the payment of debt service on the Series 1997 Bonds and the Outstanding Parity Bonds.

In addition to the foregoing, the City's general financial condition may be affected by other provisions of Article XIIC and Article XIID, including (A) provisions of Article XIIC (i) requiring taxes for general governmental purposes to be approved by a majority vote and taxes for specific purposes, even if deposited into the general fund, to be approved by a two-thirds vote, (ii) requiring any general purpose tax which the City imposed, extended or increased, without voter approval, after December 31, 1994 to be approved by majority vote by November 5, 1998, (iii) subjecting all taxes, assessments, fees and charges to reduction or repeal at any time through the initiative process (as mentioned above), and (B) provisions of Article XIID that could reduce the ability of the City to fund certain services or programs that it may be required or choose to fund from its general fund, such as provisions (1) adding requirements making it generally more difficult to levy and maintain "assessments," defined to mean a levy or charge upon real property for a particular and distinct benefit to the property over and above general benefits conveyed to property located in the district or to the public at large, (2) requiring any imposition or increase of property related fees or charges other than for sewer, water and refuse collection services or fees for electrical or gas service (which are not treated as property related for purposes of Article XIID) to be approved by "majority of the property owners" subject to the fee or charge or, at the option of the local government, two-thirds voter of the electorate residing in the affected area.

The interpretation and application of Proposition 218 will ultimately be determined by the courts or through implementing legislation with respect to a number of the matters discussed above, and it is not possible at this time to predict with certainty the outcome of such determination or the nature or scope of any such legislation.

Effect of Proposition 218 and of Possible General Limitations on Enforcement Remedies

The ability of the City to comply with its covenants under the Installment Purchase Agreement and to generate Net System Revenues sufficient to pay Installment Payments thereunder and ultimately, the ability of the Authority to pay principal of and interest on the Series 1997 Bonds and the Outstanding Parity Bonds may be adversely affected by actions and events outside of the control of the City and may be adversely affected by actions taken (or not taken) under Article XIIC or Article XIID by voters, property owners, taxpayers or payers of assessments, fees and charges. Furthermore, any remedies available to the owners of the Series 1997 Bonds and the Outstanding Parity Bonds upon the occurrence of an event of default under the Indenture are in many respects dependent upon judicial actions which are often subject to discretion and delay and could prove both expensive and time consuming to obtain. In addition to the possible limitations on the ability of the City to comply with its covenants under the Installment Purchase Agreement, the ability of the Authority to comply with its obligations under the Indenture, the rights and obligations under the Series 1997 Bonds, the Outstanding Parity Bonds, the Indenture and the Installment Purchase Agreement may be subject to bankruptcy, insolvency, reorganization, arrangement, fraudulent conveyance, moratorium and other laws relating to or affecting creditors' rights, to the application of equitable principles, to the exercise of judicial discretion in appropriate cases and to limitations on legal remedies against cities in the State of California.

Based on the foregoing, in the event the City fails to comply with its covenants under the Installment Purchase Agreement, including its covenants to generate sufficient Net System Revenues, as a consequence of the application of Article XIIC and Article XIID, or to pay Installment Payments thereunder and ultimately, the ability of the Authority to pay principal of or interest on the Series 1997 Bonds and Outstanding Parity Bonds, there can be no assurance that available remedies will be adequate to fully protect the interests of the holders of the Series 1997 Bonds and the Outstanding Parity Bonds.

Operations and Maintenance Expenses for Tijuana Effluent

For over fifty years the Tijuana River, which flows northward from Tijuana, Mexico into southern San Diego County in the United States, has been a vehicle for the intermittent transportation of raw sewage. On April 15, 1991, the City Council adopted a resolution directing the City Manager to accept sewage from Tijuana, Mexico into the emergency connection of the Metropolitan System. Currently, the emergency connection has a capacity of 13 mgd. The City entered into an annual contract with the IBWC on July 22, 1991, with the condition that the IBWC seek funding from the U.S. Congress to reimburse the City for the use of the emergency connection at a rate of \$600/mg in the fiscal year ended June 30, 1993 and in subsequent years at a rate based upon the rate charged to commercial customers. In the event the Congress does not provide sufficient appropriations for the

treatment of the Tijuana sewage, the City may terminate the contract. For the twelve months ending September 30, 1997, the rate to be charged to the IBWC will increase to \$1,027/mg. The proposed Federal fiscal year 1997 budget includes \$4,036,000 for treatment of Tijuana sewage. The IBWC is constructing the 25 mgd International Wastewater Treatment Plant in the Tijuana River Valley to treat Tijuana sewage. The International Wastewater Treatment Plant is scheduled to be completed in February 1997. The South Bay Ocean Outfall, through which effluent from the International Wastewater Treatment Plant will be discharged, is scheduled to be completed in 1998, after which time the emergency connection may no longer need to be used. The 13 mgd accepted through the emergency connection to the Metropolitan System can be shut down at any time should the Metropolitan System require additional capacity for the City or the Participating Agencies. For information regarding possible litigation involving the International Wastewater Treatment Plant, see "WASTEWATER SYSTEM REGULATORY REQUIREMENTS - Recent Compliance Actions and Other Litigation."

Historical Revenues and Debt Service Coverage

Table 12 contains the Statement of Income for fiscal years ended June 30, 1992 through 1996, and Table 13 contains the Calculation of Debt Service Coverage for such years.

Table 12
WASTEWATER SYSTEM STATEMENT OF INCOME
Fiscal Years Ended June 30, 1992 to 1996

	<u>1992</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>
OPERATING REVENUES					
Sewer Service Charges:					
Inside City:					
Domestic	\$74,596,267	\$83,158,791	\$89,630,046	\$95,333,742	\$96,113,508
Commercial and Industrial	32,465,104	35,014,552	35,072,134	37,832,852	38,460,649
Outside City:					
Domestic, Commercial and Industrial	6,756	6,138	7,866	9,270	10,151
Treatment Plant Service for Others	<u>28,880,874</u>	<u>26,986,390</u>	<u>32,360,195</u>	<u>32,271,388⁽¹⁾</u>	<u>32,920,667⁽¹⁾</u>
Total Sewer Service Revenues	135,949,001	145,165,871	157,070,241	165,447,252	167,504,975
Other Operating Revenues:					
Aquaculture Operating Grants	1,410,760	(88,264)	227,550	312,234	426,175
Miscellaneous (Net)	<u>734,550</u>	<u>588,854</u>	<u>2,779,270</u>	<u>188,111</u>	<u>1,017,445</u>
TOTAL OPERATING REVENUES	138,094,311	145,666,461	160,077,061	165,947,597	168,948,595
OPERATING EXPENSES	<u>90,839,690</u>	<u>92,317,053</u>	<u>109,938,980</u>	<u>118,354,527</u>	<u>122,983,712</u>
OPERATING INCOME	<u>47,254,621</u>	<u>53,349,408</u>	<u>50,138,081</u>	<u>47,593,070</u>	<u>45,964,883</u>
NON-OPERATING REVENUES (EXPENSES):					
Interest Income	18,210,011	11,297,768	11,289,578	16,459,340	16,834,747
Gain (Loss) on Sale/Retirement of Fixed Assets	(261,019)	(1,244,597)	(6,316,466)	(32,027,997) ⁽²⁾	(2,591,703)
Gain on Early Redemption of Bonds	3,689	8,262	0	0	0
Interest Expense	(759,467)	(663,368)	(8,355,755)	(12,467,426)	(19,928,687)
Reverse Repurchase - Interest Expense	(1,000,212)	(538,465)	(740,345)	(2,529,402)	(1,113,892)
Non-Operating Grants	0	0	0	0	14,673,091
Other	<u>0</u>	<u>8,414,603</u>	<u>191,065</u>	<u>1,302,334</u>	<u>(9,679,670)</u>
TOTAL NON-OPERATING REVENUES (EXPENSES)	<u>16,193,002</u>	<u>17,274,203</u>	<u>(3,931,923)</u>	<u>(29,263,151)</u>	<u>(1,806,114)</u>
Operating Transfer In	90,377	0	0	80,896	173,040
Operating Transfer Out	<u>(500,000)</u>	<u>(500,000)</u>	<u>(1,109,403)</u>	<u>(1,414,104)</u>	<u>(2,737,000)</u>
NET INCOME	<u>\$63,038,000</u>	<u>\$70,123,611</u>	<u>\$45,096,755</u>	<u>\$16,996,711</u>	<u>\$41,594,809</u>

- (1) \$15,286,325 and \$11,432,090 of revenues billed and received from the Participating Agencies for the fiscal years 1995 and 1996 were not included as the Participating Agencies were disputing the billings. See "WASTEWATER SYSTEM - The Participating Agencies and Sewage Disposal Agreements and Other Agreements."
- (2) See "Management's Discussion and Analysis - Gain (Loss) on Sale/Retirement of Fixed Assets."

Table 13
CALCULATION OF DEBT SERVICE COVERAGE
Fiscal Years Ended June 30, 1992 to 1996

(Unaudited)

	<u>1992</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>
TOTAL OPERATING REVENUES	\$138,094,311	\$145,666,461	\$160,077,061	\$165,947,597	\$168,948,595
OPERATING EXPENSES:					
Transmission	16,202,921	20,192,251	23,481,764	31,786,946	33,264,059
Treatment and Disposal Plant	43,727,966	38,145,441	45,125,696	44,121,508	39,406,012
Special Projects	5,730,384	5,682,992	6,663,570	7,492,445	0
Accounting	2,117,041	2,249,741	2,228,585	2,471,754	2,160,301
General and Administrative	<u>14,524,143</u>	<u>17,354,870</u>	<u>22,208,293</u>	<u>22,423,239</u>	<u>37,186,483</u>
TOTAL OPERATING EXPENSES ⁽¹⁾	<u>82,302,455</u>	<u>83,625,295</u>	<u>99,707,908</u>	<u>108,295,892</u>	<u>112,016,855</u>
TOTAL OPERATING INCOME	<u>55,791,856</u>	<u>62,041,166</u>	<u>60,369,153</u>	<u>57,651,705</u>	<u>56,931,740</u>
OTHER INCOME (CHARGES):					
Capital Grant Receipts	0	0	23,682,613	33,115,894	48,629,476
Operating Transfer In/(Out)	(409,623)	(500,000)	(1,109,403)	(1,333,208)	(2,563,960)
Trunk Line Sewer Area Charge	26,177	0	(361,382)	(73,491)	0
Capacity Charge Municipal System	12,385,388	10,920,494	15,136,994	11,439,060	12,523,907
Interest Income	18,210,011	11,212,178	11,289,578	16,459,340	16,834,747
Reverse Repurchase Agreement Interest Expense	(1,000,212)	(538,465)	(740,345)	(2,529,402)	(1,113,892)
Rate Stabilization Fund	0	0	0	0	(10,000,000)
Other Income	<u>0</u>	<u>8,500,193</u>	<u>423,229</u>	<u>1,534,499</u>	<u>(9,149,987)</u>
TOTAL OTHER INCOME	<u>29,211,741</u>	<u>29,594,400</u>	<u>48,321,284</u>	<u>58,612,692</u>	<u>55,160,291</u>
NET REVENUE AVAILABLE FOR DEBT SERVICE	<u>85,003,597</u>	<u>91,635,566</u>	<u>108,690,437</u>	<u>116,264,397</u>	<u>112,092,031</u>
DEBT SERVICE COVERAGE					
Principal and Interest Due in Fiscal Year	2,974,770	2,971,820	9,962,877	16,319,661	24,428,688
Coverage	28.57	30.83	10.91 ⁽²⁾	7.12	4.59

(1) The difference between Operating Expenses in Tables 12 and 13 is due to depreciation expense being excluded in Table 13.

(2) Does not equal Exhibit D of the fiscal year 1994 Financial Statements as Capital Grant Receipts were excluded from income in the computation of debt service coverage. The 1995 and 1996 Financial Statements included Capital Grant Receipts as income in the computation of debt service coverage, in accordance with the terms and conditions of the Installment Purchase Agreement.

Management's Discussion and Analysis

The following discussion relates to certain items shown in Table 12.

Operating Revenues. Sewer service charges for domestic customers increased consistently from 1992 to 1995 due primarily to increased rate levels. In 1996, the revenues leveled off as there were no rate increases. The City Council adopted 6% per year rate increases for years 1997 and 1998. Commercial and Industrial charges declined in 1992 primarily due to water conservation efforts undertaken during California's seven-year drought, which ended in 1993.

The increase in Treatment Plant Service for Others revenue in 1992 to 1996 was due to increased payments from the Participating Agencies for construction costs and debt service payments related to the Wastewater System Capital Improvement Plan.

Operating Expenses. Operating expenses increased from 1993 to 1996 primarily due to increased sludge disposal costs, administrative costs and the imposition of right-of-way charges ("ROW charges") in 1994, 1995 and 1996. In each of the last three fiscal years, the City has imposed ROW charges, payable to the General Fund, on the Wastewater System for use by the MWW of City streets for sewage lines. In fiscal year 1994, 1995 and 1996, these charges were based on miles of sewer pipes and the number of manholes in the City rights-of-way, using methodology similar to the City's PUC-approved calculations of charges for other pipelines in the right-of-way. Beginning in fiscal year 1997, the basis for calculation of the charges was changed to a fixed percentage (5%) of operating revenues. This methodology mirrors the City's charges to other franchises, such as cable TV and electric utilities, for use of the right-of-way. The charges are considered Wastewater System maintenance and operations charges and are therefore expenses which are payable prior to Parity Obligations, including the Series 1997 Bonds. The City's right-of-way charges for the fiscal years ended June 30, 1994, 1995 and 1996 were \$3.1 million, \$5.5 million and \$8.3 million, respectively. Charges in fiscal 1997 have been budgeted at \$7.1 million.

For the fiscal year ended June 30, 1996, the City Council approved the imposition upon the Sewer Revenue Fund of a \$2.1 million, for the purpose of reimbursing other City funds for certain storm drain related expenses. The intended uses of this amount were an educational program concerning the National Pollutant Discharge Elimination System, reimbursing the public liability reserve for related storm drain related claims, and construction of storm drains. This charge had not previously been imposed upon the Wastewater System and was characterized by the City Council at the time as a one time assessment. It has not been charged to the Wastewater System subsequently.

If the ROW charges were to continue to escalate or other assessments, such as the storm drain charge, were to continue to be imposed, the financing capacity of the Wastewater System could be reduced. In this regard, the City is required to fix rates for the Wastewater System such that charges for wastewater services will be at least equal to pay all outstanding Obligations (other than Parity Obligations) and to provide Net System Revenues equal to 120% of Debt Service for the year. See "SECURITY FOR THE SERIES 1997 BONDS - Rate Covenant; Impact of Proposition 218."

Interest Income. Interest income decreased in 1992 to 1994 due to declining interest rates. Although in 1994 the amount of interest income was about the same as in 1993, it was generally on a much larger cash balance than in 1993 and reflected declining interest rates. Interest income increased in 1995 and 1996 due to higher yields resulting from longer term investments in addition to larger cash balances in pooled cash.

Gain (Loss) on Sale/Retirement of Fixed Assets. In 1994 and 1995, the loss experienced was due to a write-off of the costs of projects that are no longer being pursued because the City had successfully changed from Alternative IVa to the Consumers' Alternative as a result of a U.S. District Court order. See "ACTIONS UNDER CLEAN WATER ACT."

Interest Expense. Interest Expense increased in 1994, 1995 and 1996 because of the issuance of the Series 1993 Bonds and the Series 1995 Bonds.

Reverse Repurchase - Interest Expense. Interest expense on reverse repurchase transactions increased in 1995 primarily due to an increase in long term investments resulting in increased reverse repurchase activity.

Non-Operating Grants. Revenues from this source increased from 1995 to 1996 due to a new agreement with the IBWC to construct the federal portion of the South Bay Ocean Outfall, an outfall running seaward from the Tijuana River Estuary. The outfall will be jointly owned by the IBWC and the City. The revenue reported is a pass through to cover the Federal share of the project costs.

Other. Other non-operating revenues increased in 1993 due to the receipt of one-time insurance proceeds related to the break of the Point Loma Plant Ocean Outfall. The increase in 1995 is due to a reclassification of revenues from Operating Revenues - Miscellaneous. In 1996, the expenses increased due to the expensing of construction costs for the IBWC share of the South Bay Ocean Outfall.

Operating Transfer Out. In 1992 to 1996, \$500,000 was transferred to the Water Operating Fund of the Water Utilities Department to fund the rebate program for water conservation fixtures described in "ACTIONS UNDER THE CLEAN WATER ACT - Litigation and Proposed Consent Decree." The amounts in excess of \$500,000 in 1994 and 1995 were due to transfers to the Authority to replenish the Reserve Fund securing the Series 1993 Bonds due to a market

devaluation. The increase in 1996 is due to a one time transfer out to reimburse other City funds for storm drain related expenses.

The following discussion relates to certain items shown in Table 13.

General and Administrative. General and Administrative costs increased due to a reclassification of costs from Special Projects to General and Administrative. The additional increase is due to increased costs in data processing and costs incurred to obtain the waiver.

Capacity Charge Municipal System. Capacity Charge revenues declined in 1995 due to a reduction in the level of construction in the service area and increased in 1996. A 64% reduction in capacity charges was approved in 1996 by the City Council in order to stimulate economic development and affordable housing. Sewer capacity charges were reduced from \$6,998 to \$2,500 per equivalent dwelling unit.

FINANCIAL PROJECTIONS

Set forth below in Table 14 are the projected estimated cash receipts and operating expenditures for the seven fiscal years ending June 30, 2003. Table 14 incorporates the assumptions described below, including assumed inflation and interest rates, rate increases and the amount of indebtedness to be issued during the projection period. For purposes of complying with the Continuing Disclosure Agreement, the actual results for any future year specified in Table 14 will be reflected in Schedule F-1 and F-2 of the City annual financial statements for that year and will be comparable to the financial data contained in Schedules F-1 and F-2 of the financial statements attached as Appendix A. Alternatively, the actual results may be published in tabular form, comparable to Table 14. The City has chosen to analyze prospective rate covenant coverage on the basis of projected cash receipts and operating expenses when paid. Accordingly, the method of calculating Net Revenue for Table 14 differs from the method of calculating Net Revenue Available For Debt Service for Table 13.

Not reflected in the following financial projections is another potential source of funds that the City is considering through the State of California State Revolving Fund Program operated by the State Board. Currently, the Program only allows agencies, such as the City, to borrow a maximum of \$5 million per year from the Program. The State Board, however, has recently recommended that the Program be revised to allow agencies to borrow a maximum of \$50 million per year. Depending upon the outcome of the State Board recommendation, the State Revolving Fund could provide an additional funding source to the City of up to \$50 million per year for capital expenditures. Any amounts borrowed by the City pursuant to the State Revolving Fund Program would replace and thus reduce the principal amount of any new bond issues which are discussed below in paragraph 7 under "Projected Operating Results."

Table 14
FINANCIAL PROJECTIONS
(In Thousands of Dollars)
Fiscal Years Ending June 30, 1997 to 2003
(Unaudited)

	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>1996</u> <u>Actual</u> ⁽²⁾
ESTIMATED REVENUES								
Sewer Service Charge Revenues	\$139,494	\$153,947	\$168,776	\$182,368	\$201,375	\$220,639	\$242,642	\$132,721
New Sewer Service Connections	110	112	113	115	117	119	121	97
Sewage Treatment Plant Services	42,462	46,275	44,008	45,413	50,200	47,745	48,689	31,589
Sludge Handling Charge	125	127	130	131	134	136	138	115
Interest Earnings ⁽¹⁾	18,045	18,457	18,289	18,321	17,076	15,048	13,840	15,597
Services Rendered Other Funds	365	376	387	399	415	431	449	908
Capacity Charge Municipal System	5,072	5,326	5,592	5,872	6,165	6,474	6,797	12,524
Sale of Electricity/Gas Engine Generation	215	221	228	235	244	254	264	225
Contributions in Aid	78,881	29,306	8,427	0	0	0	0	49,056
Other Revenue	1,283	1,300	1,316	1,334	1,357	1,382	1,408	(265)
Rate Stabilization Fund Transfer ⁽³⁾	(30,000)	(5,000)	17,000	18,000	6,000	(2,000)	(11,000)	(10,000)
TOTAL ESTIMATED REVENUES	\$256,052	\$250,447	\$264,266	\$272,188	\$283,083	\$290,228	\$303,348	\$232,567
OPERATING EXPENDITURES								
Total Maintenance & Operation	(142,544)	(154,018)	(156,057)	(162,261)	(169,124)	(175,889)	(182,925)	112,284
NET SYSTEM REVENUE	<u>\$113,508</u>	<u>\$ 96,429</u>	<u>\$108,209</u>	<u>\$109,927</u>	<u>\$113,959</u>	<u>\$114,339</u>	<u>\$120,423</u>	<u>\$120,283</u>
COVERAGE TEST								
Net System Revenue	\$113,508	\$ 96,429	\$108,209	\$109,927	\$113,959	\$114,339	\$120,423	\$120,283
Annual Debt Service	43,335	65,212	78,237	88,146	91,191	91,190	91,187	34,429
DEBT SERVICE COVERAGE	2.62	1.48	1.38	1.25	1.25	1.25	1.32	4.93

(1) Includes interest on Debt Service Reserve Fund as indicated in the Authority's financial statements, but excludes interest on Construction Fund.

(2) Included to comply with the Continuing Disclosure Agreement entered into in connection with the issuance of the Series 1995 Bonds.

(3) See paragraph 4 under "Projected Operating Results" below for the possible effect of Proposition 218 on the City's ability to set rates and charges sufficient to make the projected deposits to the Rate Stabilization Fund.

Projected Operating Results

Table 14 provides the operating revenues of the Wastewater System for the fiscal years ending June 30, 1997 through June 30, 2003.

The following reflects the principal assumptions used in the preparation of these financial projections:

1. The Metropolitan System will continue to be owned and operated by the City and the facilities contained in the Metropolitan Wastewater Plan will be constructed and come into operation as currently planned by the City.
2. The City will continue to maintain a 45-day operating reserve.
3. Maintenance and operations expenditures (in thousands) for the fiscal years ending June 30, 1997 through June 30, 2003 will be as follows:

	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
Municipal System	\$52,122	\$ 55,722	\$ 56,864	\$ 58,570	\$ 61,050	\$ 63,492	\$ 66,032
Metropolitan System	<u>90,422</u>	<u>98,296</u>	<u>99,193</u>	<u>103,691</u>	<u>108,074</u>	<u>112,397</u>	<u>116,893</u>
TOTAL	\$142,544	\$154,018	\$156,057	\$162,261	\$169,124	\$175,889	\$182,925

Inflation rates were applied to maintenance and operations estimates as follows: 3.0% for the fiscal years ending June 30, 1998 through June 30, 2000 and 4.0% per year for each fiscal year thereafter. (The comparable percentages for the Municipal System appearing in the Prior Official Statement were 4% and 5%, respectively). Total maintenance and operations costs for this seven year period are consistent with those contained in the Prior Official Statement.

4. For the fiscal years ending June 30, 1997 through June 30, 2003, growth projections of single family residential accounts are based upon growth projections of population prepared by the San Diego Association of Governments. Sewer service charges are assumed to increase by 0% in the fiscal year ending June 30, 1996, by 6.0% in fiscal years ending June 30, 1997 through 1999 and by 8.0% in fiscal years ending June 30, 2000 through 2003. It is unclear whether under Proposition 218 the City can make deposits to the Rate Stabilization Fund. If it were determined that Proposition 218 prevented the City from setting rates and charges sufficient to make the deposits projected on Table 14 and without making any alterations to the other financing assumptions, the rate increase of 6% in the fiscal year ending June 30, 1999 would have to be changed to an increase of 14% and the increases of 8% in the fiscal years ending June 30, 2000 through 2003 would have to be changed to increases of 8% in the fiscal year ending June 30, 2000, 4% in the fiscal year ending June 30, 2001 and 2% in the fiscal years ending June 30, 2002 and 2003. See "WASTEWATER SYSTEM FINANCIAL OPERATIONS - Impact of Proposition 218 on Sewer Service Rates and Charges." No increases in capacity charge rates are assumed. New system hook-ups (measured in EDU's) are projected based on the average of the last five years, increased at 5.0% per year. These projections are summarized below:

*For the Fiscal Year Ending June 30,
Projected*

	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
Single-Family Monthly Service Charge (Average)	\$24.28	\$25.74	\$27.28	\$29.46	\$31.82	\$34.37	\$37.12
Single-Family Residential Accounts	202,006	205,060	208,114	211,169	214,521	218,170	221,820
Total Service Charge Revenues (000)	\$139,494	\$153,947	\$168,776	\$182,368	\$201,375	\$220,639	\$242,642
Capacity Charge (Per EDU)	\$2,500	\$2,500	\$2,500	\$2,500	\$2,500	\$2,500	\$2,500
Annual Increase in EDU's	2,205	2,316	2,431	2,553	2,681	2,815	2,955
Total Capacity Charge Revenue (000)	\$5,072	\$5,326	\$5,592	\$5,872	\$6,165	\$6,474	\$6,797

5. The City will fund the capital costs of the Wastewater System Capital Improvement Plan from a combination of proceeds of indebtedness and Wastewater System revenues as set forth in Table 5.

6. The average annual interest rate on indebtedness issued to finance the Wastewater System Capital Improvement Plan will be 6.5 % for fiscal year ending June 30, 2003, and such debt will be amortized over 30 years from time of issuance. This is lower than the 7.0 % average annual interest rate specified in the Prior Official Statement and is based upon a reevaluation of expected long-term interest costs.

7. The amount of indebtedness (in thousands) that will be issued in each of the fiscal years ending June 30, 1997 through June 30, 2003 to fund the Wastewater System Capital Improvement Program will be as follows:

<u>Fiscal Year Ending June 30,</u>	<u>Principal Amount</u>
1997	\$250,000
1998	\$161,092
1999	\$179,103
2000	\$ 79,543
2001	0
2002	0
2003	0

Including the issuance of the Outstanding Parity Bonds in 1993 and 1995, the total amount of indebtedness described above is approximately \$1.269 billion (including approximately \$185 million of debt related to the Municipal System). This amount compares with approximately \$1.260 billion of total indebtedness (and \$150 million of debt related to the Municipal System) assumed in the Prior Official Statement. The amounts of indebtedness contained in the preceding table would be reduced by the amounts, if any, the City may borrow pursuant to the State Revolving Fund Program.

8. The average annual interest rate on invested funds will be 5.0%. This interest rate assumption is consistent with the assumption appearing in the Prior Official Statement.

9. The Participating Agencies will contribute up to 28.99 % of the total Metropolitan System effluent flow and will pay maintenance and operations expenses together with capital costs associated with the repair, replacement and betterment of the Metropolitan System based upon their proportionate discharge of wastewater. The Participating Agencies will pay their proportionate share of the costs of the Metropolitan System Capital Improvement Program including the capital costs associated with the expansion of the Point Loma Plant up to 234 mgd but excluding the costs of any further expansion beyond 234 mgd and any water reclamation projects. The costs associated with reclamation and Metropolitan System expansion beyond 234 mgd projects are estimated to be \$128 million.

The City Auditor and Comptroller is holding approximately \$40 million of payments paid by the Participating Agencies under protest. As described above under "WASTEWATER SYSTEM - The Participating Agencies and Sewage Disposal Agreements and Other Agreements," the City and the Participating Agencies have entered into the Principles of Understanding in order to resolve the billing disputes. All of the Participating Agencies have delivered a written waiver of protest to the City. When certain actions by the City Council have occurred, the City Auditor and Comptroller will release the disputed amounts into revenues. The City expects that the funds will be released in the near future. However, the release of these funds is not reflected in Table 14. In addition, once certain actions by the City Council have occurred, the City will also plan to receive future payments from the Participating Agencies based on the agreement set forth in the Principles of Understanding and described under "WASTEWATER SYSTEM - The Participating Agencies and Sewage Disposal Agreements and Other Agreements."

10. Annual flows of the City for fiscal years ending June 30, 1997 through June 30, 2003 will be as follows:

	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
Annual Flows - mgd	134	135	139	140	143	145	147
Percent (%) Increase	0.98	1.12	2.96	0.36	2.15	1.40	1.73

These flow projections are consistent with those appearing in the Prior Official Statement.

LABOR RELATIONS

Approximately 98% of the MWWD employees are represented by either the Municipal Employees Association ("MEA") or the American Federation of State and County Municipal Employees ("Local 127"). In general, the MEA represents all technical, professional, and supervisory staff and administrative support personnel. Local 127 represents maintenance workers, laborers, skilled trades positions and equipment operators.

MEA represented employees and the Local 127 represented employees received a 1% increase effective June 3, 1995. Under the current agreement, both the MEA and Local 127 represented employees received 3% increases effective December 30, 1995 and December 28, 1996.

PENSION PLAN

All the MWWD employees along with all other City employees and employees of the San Diego Unified Port District, participate in the City Employees' Retirement System ("CERS"). As a multiple-employer public employee retirement system, CERS acts as a common investment and administrative agent for both the City and the San Diego Unified Port District. CERS provides retirement benefits to all of its members through a variety of benefit plans.

The CERS plans are structured as defined benefit plans in which benefits are based on salary, length of service and age. The MWWD employees and other City employees are required to contribute a percentage of their annual salary to CERS. State legislation requires the City to contribute to CERS at rates determined by actuarial valuations.

The City's last annual valuation dated June 30, 1995 stated the funding ratio (Net Assets available for Benefits to Pension Benefit Obligation) of the CERS fund to be 86.8 %. However, as there are some ongoing meet and confer items being discussed, the Actuarial Report has not been ratified by the Retirement Board but is expected to be ratified in the near future. The CERS fund has an Unfunded Actuarial Accrued Liability (UAAL) of \$96.3 million as of June 30, 1995. The UAAL is the difference between total actuarial accrued liabilities of \$1.477 billion and assets allocated to funding of \$1.380 billion. The UAAL is amortized over a 30 year period which started July 1, 1991, with each year's amortization payment reflected as a portion of the percentage of payroll representing the employer's contribution rate. As of June 30, 1995, there were 26 years remaining in the amortization period.

INSURANCE

The MWWD is self insured for workers' compensation and long-term disability and for public liability claims exposure up to \$3 million per occurrence. For liability between \$3 million and \$25 million, the MWWD is covered by the City which purchases insurance from commercial insurers in layers for its public liability exposure.

Table 15 reflects the annual budget and expenditures for liability claims of the Wastewater System for fiscal years 1992 through 1997 follow:

Table 15
LIABILITY CLAIMS BUDGET AND EXPENDITURES
Fiscal Years Ending June 30, 1992 to 1997

(Unaudited)

<u>Fiscal Year</u>	<u>Budget</u>	<u>Expenditure</u>
1992	\$1,114,000	\$2,516,000
1993	\$1,464,000	\$1,660,000
1994	\$1,464,000	\$1,710,000
1995	\$1,464,000	\$1,458,000
1996	\$1,464,000	\$ 964,295
1997	\$1,464,000	--

As of July 1, 1996, Sewer Revenue Fund liability reserve totaled \$340,553.

The City maintains commercial property insurance on all City owned buildings of an insurable nature, and currently carries property and extended loss insurance coverage of \$200 million per occurrence with a \$25,000 deductible on all City buildings, with earthquake insurance coverage of up to \$100 million on all bond-funded buildings. Depending on availability and affordability of such earthquake insurance, the City may elect not to purchase such coverage in the future. The City does not maintain any casualty insurance on the pipelines of the Wastewater System as such insurance is not commercially available.

Insurance for the projects contemplated by the Wastewater System Capital Improvement Plan is provided by the City through an Owner Controlled Insurance Program through a single private insurance companies which provides liability insurance coverage in the amount of \$100 million. The Owner Controlled Insurance Program provides general liability, workers' compensation and builder's risk property insurance for all contractors working on the MWWD's construction sites.

INVESTMENT OF FUNDS⁽¹⁾

The Treasurer of the City, in accordance with the Charter of the City, is responsible for investing the unexpended cash in the Treasurer's pooled operating investment fund (the "Pool"). Responsibility for the daily investment of funds in the Pool is delegated to the City's Investment Officer. The City is the only participant in the Pool; there are no other Pool participants either voluntary or involuntary. The investment objectives of the Pool are preservation of capital, liquidity and return.

Oversight and Reporting Requirements

The City Treasurer provides an investment report on a monthly basis to the City Manager, the City Auditor/Comptroller, and the City Council and annually presents a statement of investment policy (the "Investment Guidelines") to the City Manager, the City Council and the City Manager's Investment Advisory Committee. The Investment Advisory Committee was established in March 1990 and is comprised of the City Auditor and Comptroller, the Financial and Technical Services Manager and two investment professionals from the private sector. The Committee is charged with oversight responsibility to review on an on-going basis the Investment Guidelines and practices of the City Treasurer and recommend changes. Investments in the Pool are audited by an independent firm of certified public accountants as part of the overall audit of the City's financial statements.

The City's investment section utilizes outside services to provide investment portfolio valuations and accounting and reporting services. The service provides monthly portfolio valuation, investment performance statistics and other statistical security reports which are distributed to the City Treasurer accounting section and the City Auditor and Comptroller's office for review and reconciliation. The City Treasury accounting section prepares a series of monthly reports, which includes portfolio market valuation, and distributes these to the Mayor, City Council, City Manager and other officials.

Authorized Investments

Investments in the Pool are governed by State law and further restricted by the City's Investment Guidelines. The Investment Guidelines have been written with safety of principal being their foremost objective. Permitted investments include U.S. Treasury securities, U.S. Agency securities, corporate medium term notes, money market instruments and the Local Agency Investment Fund (California State Pool). Reverse repurchase agreements are restricted to 20% of the cash balances placed in the Pool (excluding amounts obtained in reverse repurchase transactions) and are governed by various maturity restrictions as well. There were no reverse repurchases outstanding as of September 30, 1996. The main operating funds of the City are currently being managed in two separate portfolios. In its management of the 'Liquidity' portfolio, comprising about 50% of the total funds, the City invests in a variety of debt securities with maturities ranging from one day to one year; it measures its performance against the Merrill Lynch 3 to 6 month U.S. Treasury Bill Index. The portfolio is structured to adequately provide liquidity for all of the City's cash flow requirements. The remaining 50% of the funds are managed in a separate 'Core' portfolio, which are invested in a variety of debt securities ranging from one day to five years; it measures its performance against the Merrill Lynch 1 to 3 year U.S. Treasury Index. Safety of principal and liquidity are the paramount considerations in the management of both portfolios.

The Pool does not engage in securities lending transactions.

(1) The information contained under this heading relating to information on the Pool as of June 30, 1996 was included in order to comply with the Continuing Disclosure Agreement entered into in connection with the issuance of the Series 1995 Bonds.

Pool Liquidity and Other Characteristics

The Pool (including both the "Liquidity" and the "Core" portfolios) is highly liquid. As of September 30, 1996, approximately 16% of the Pool investments matured within 60 days, 20% within 90 days and 34% within 180 days (on a cumulative basis). As of September 30, 1996, the Pool had a weighted average maturity of 1.26 years (458 days) and its weighted yield was 5.98%. As of June 30, 1996, approximately 20% of the Pool investments matured within 60 days, 22% within 90 days and 35% within 180 days (on a cumulative basis). As of June 30, 1996, the Pool had a weighted average maturity of 1.33 years (487 days) and its weighted yield was 5.97%. (For purposes of calculating weighted average maturity, the City Treasurer treats investments in the Local Agency Investment Fund (California State Pool) as maturing within one day. Duration is a measure of the price volatility of the portfolio which reflects an estimate of the projected increase or decrease in the value of the portfolio based upon a decrease or increase in interest rates. The Pool has a duration of 1.2 years, which implies that for every 1% increase in market rates, the market value of the portfolio would decrease by approximately 1.2%). The Pool composition is designed to ensure that sufficient liquid funds are available to meet disbursement requirements. The composition and value of investments under management in the City's Investment Pool will vary from time to time depending on the cash flow needs of the City, maturity or sale of investments, purchase of new securities and fluctuations in interest rates generally.

Table 16
SUMMARY OF ASSETS IN THE
CITY OF SAN DIEGO POOLED INVESTMENT FUND
(In Millions of Dollars)
As of September 30, 1996

(Unaudited)

	<u>Book Value</u>	<u>Market Value</u>	<u>Percent of Total⁽¹⁾</u>
U.S. Treasury Bills and Notes	\$451,813,686	\$453,397,500	49.8%
Federal Agency Securities	246,929,447	245,345,633	27.2
Medium Term Notes (Corporate) ⁽¹⁾	70,169,910	70,038,288	7.7
Money Market Investments ⁽²⁾	130,394,425	130,450,873	14.4
Local Agency Investment Fund	<u>8,382,772</u>	<u>8,382,772</u>	<u>.9</u>
Net Assets	\$907,690,240	\$907,615,066	100.0%

(1) These notes consist of both fixed and floating interest rate securities. The notes with floating interest rates are reset at intervals ranging from one day to three months.

(2) These securities consist of commercial paper, negotiable certificates of deposit, term and overnight repurchase agreements, banker's acceptances, bank notes and thrift notes.

The following table presents the information contained above in Table 16 for the year ended June 30, 1996 in order to comply with the Continuing Disclosure Agreement entered into in connection with the issuance of the Series 1995 Bonds.

**SUMMARY OF ASSETS IN THE
CITY OF SAN DIEGO POOLED INVESTMENT FUND
(In Millions of Dollars)
As of June 30, 1996**

(Unaudited)

	<u>Book Value</u>	<u>Market Value</u>	<u>Percent of Total⁽¹⁾</u>
U.S. Treasury Bills and Notes	\$535,349,468	\$537,157,954	54.5%
Federal Agency Securities	207,131,081	205,285,539	21.0
Medium Term Notes (Corporate) ⁽¹⁾	80,159,910	80,042,975	8.2
Money Market Investments ⁽²⁾	151,323,317	151,477,576	15.4
Local Agency Investment Fund	<u>8,432,313</u>	<u>8,432,313</u>	<u>.9</u>
Total Assets ⁽³⁾	\$982,396,089	\$982,396,357	100.0%
Less Reverse Repo Liability ⁽⁴⁾	<u>(19,111,500)</u>	<u>(19,111,500)</u>	
Net Assets	<u>\$963,284,589</u>	<u>\$963,284,857</u>	

- (1) These notes consist of both fixed and floating interest rate securities. The notes with floating interest rates are reset at intervals ranging from one day to three months.
- (2) These securities consist of commercial paper, negotiable certificates of deposit, term and overnight repurchase agreements, banker's acceptances, bank notes and thrift notes.
- (3) Includes the investment of proceeds received by the Pool upon the sale of securities in reverse repurchase transactions.
- (4) The aggregate amount payable by the Pool upon the repurchase of securities sold by the Pool in reverse repurchase transactions.

Derivatives

As of September 30, 1996, the City's Investment Pool had less than 5% of its assets invested in structured notes or derivatives. As of June 30, 1996, the City's Investment Pool had less than 4% of its assets invested in structured notes or derivatives. The City Treasurer defines a derivative as a financial instrument whose value is derived from an underlying asset, price, index or rate, e.g. options, futures or interest rate swaps. A structured note is an investment instrument which can contain within its structure various combinations of derivatives such as imbedded calls and interest rate swaps that will offer returns to an investor within a defined set of parameters and interest rate scenarios, e.g. step-ups, multiple-indexed notes, inverse floaters or leveraged constant maturity notes. The City Treasurer does not define fixed rate notes, debentures with call features or single index non-leveraged floating rate notes, e.g. monthly LIBOR plus or minus a spread, as structured notes. The City Treasurer limits structured notes eligible for purchase to those investments, which at the time of purchase, have no risk of principal loss if held to maturity and offer an estimated return at purchase sufficiently in excess of a comparable rate of return on a fixed term investment in the judgment of the City's Investment Officer. The City Treasurer does not permit the purchase of securities that have a negative amortization of principal. In addition, recently enacted California law prohibits the purchase of inverse floaters, range notes or interest only strips that are derived from pools of mortgages.

Reverse Repurchase Agreements

Although the City from time to time utilizes reverse repurchase agreements (or "reverse repos"), as of September 30, 1996, the City has no reverse repurchase agreements in the Pool. As of June 30, 1996, the City had less than 2% of the cash balances placed in the Pool (excluding amounts obtained in reverse repurchase transactions) in reverse repos. The Investment Guidelines require that all proceeds of a reverse repo be reinvested in securities whose maturity date or coupon reset date match the maturity on the reverse. The Investment Guidelines limit the use of reverse repos to 20% of the base value of the Pool. The City's reverse repo program is monitored daily and reported monthly, as described above under "Oversight and Reporting Requirements."

POSSIBLE TRANSFER OF OWNERSHIP OF METROPOLITAN SYSTEM

The San Diego Wastewater Management District

The California legislature has created the San Diego Wastewater Management District (the "District") to provide wastewater treatment services on a regional basis. The legislation creating the District was an outgrowth of a consensus developed by representatives of the City, the Participating Agencies and others to provide a regional approach to wastewater treatment. Initially, the District consisted of 13 member agencies, including the City. However, as a consequence of unresolved issues relating to cost sharing and governance among the member agencies, the City has withdrawn from the District. From time to time, certain other member agencies have withdrawn from the District and certain have rejoined. There is nothing preventing any or all of the withdrawing agencies from rejoining the District.

One of the purposes of the District is to assume ownership and operation of the Metropolitan System. Under the Installment Purchase Agreement, the City has retained the right to transfer ownership of the Metropolitan System to the District upon the assumption by the District of the City's obligations with respect to the Metropolitan System, including its obligation to make Installment Payments relating to components of its Metropolitan System. The City has made no determinations with respect to whether it will return to the District as a member or whether it will transfer ownership of the Metropolitan System to the District.

Installment Purchase Agreement Conditions For Transfer of Metropolitan System

Under the Installment Purchase Agreement, the City has retained the right to transfer ownership of the Metropolitan System, including amounts in the Sewer Revenue Fund attributable to the Metropolitan System, to the District or any other governmental agency whose primary purpose is to provide wastewater treatment and disposal service, provided such entity agrees to assume all Obligations the proceeds of which were used to acquire components which are part of the Metropolitan System and all other obligations relating to the Metropolitan System which are payable from Metropolitan System Revenues, Net Metropolitan System Revenues, System Revenues or Net System Revenues, including but not limited to salaries and benefits payable to employees who are to become employees of such entity, all accounts payable, Qualified Swap Agreements, Credit Provider Reimbursement Obligations and all other obligations with respect thereto such as capital improvement expenditure obligations and tort claims, and the obligation to pay fines, penalties or damages arising out of or relating to violations of federal, state or local laws or regulations which are applicable or purported to be applicable to the operation of the Metropolitan System and provided that the conditions described in "APPENDIX D - SUMMARY OF PRINCIPAL LEGAL DOCUMENTS - The Installment Purchase Agreement - Selected Covenants of the City - Transfer of Metropolitan System Components" are met. Among other conditions, the Installment Purchase Agreement requires a rating confirmation and a bond counsel opinion before the City may transfer the Metropolitan System.

Upon any such transfer of the Metropolitan System, the City shall be relieved and discharged from any and all obligations payable from Net Metropolitan System Revenues, including the Installment Payments relating to the Series 1997A Bonds and the Outstanding Parity Bonds. Upon any such transfer of the Metropolitan System, the Wastewater System shall mean the Municipal System with respect to the City and the Metropolitan System with respect to such transferee.

TAX MATTERS

In the opinion of Orrick, Herrington & Sutcliffe LLP and Lofton, De Lancie & Nelson, Co-Bond Counsel, based upon an analysis of existing laws, regulations, rulings and court decisions, and assuming, among other matters, compliance with certain covenants, interest on the Series 1997 Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986 (the "Code") and is exempt from State of California personal income taxes. Co-Bond Counsel are further of the opinion that interest on the Series 1997 Bonds is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, although Co-Bond Counsel observe that such interest is included in adjusted current earnings in

calculating federal corporate alternative minimum taxable income. A complete copy of the proposed form of opinion of Co-Bond Counsel is set forth in Appendix E hereto.

To the extent the issue price of any maturity of the Series 1997 Bonds is less than the amount to be paid at maturity of such Series 1997 Bonds (excluding amounts stated to be interest and payable at least annually over the term of such Series 1997 Bonds), the difference constitutes "original issue discount," the accrual of which, to the extent properly allocable to each owner thereof, is treated as interest on the Series 1997 Bonds which is excluded from gross income for federal income tax purposes and State of California personal income taxes. For this purpose, the issue price of a particular maturity of the Series 1997 Bonds is the first price at which a substantial amount of such maturity of the Series 1997 Bonds is sold to the public (excluding bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters, placement agents or wholesalers). The original issue discount with respect to any maturity of the Series 1997 Bonds accrues daily over the term to maturity of such Series 1997 Bonds on the basis of a constant interest rate compounded semiannually (with straight-line interpolations between compounding dates). The accruing original issue discount is added to the adjusted basis of such Series 1997 Bonds to determine taxable gain or loss upon disposition (including sale, redemption, or payment on maturity) of such Series 1997 Bonds. Owners of the Series 1997 Bonds should consult their own tax advisors with respect to the tax consequences of ownership of Series 1997 Bonds with original issue discount, including the treatment of purchasers who do not purchase such Series 1997 Bonds in the original offering to the public at the first price at which a substantial amount of such Series 1997 Bonds is sold to the public.

The Code imposes various restrictions, conditions and requirements relating to the exclusion from gross income for federal income tax purposes of interest on obligations such as the Series 1997 Bonds. The City and the Authority have covenanted to comply with certain restrictions designed to insure that interest on the Series 1997 Bonds will not be included in federal gross income. Failure to comply with these covenants may result in interest on the Series 1997 Bonds being included in gross income for federal income tax purposes, possibly from the date of issuance of the Series 1997 Bonds. The opinion of Co-Bond Counsel assumes compliance with these covenants. Co-Bond Counsel have not undertaken to determine (or to inform any person) whether any actions taken (or not taken) or events occurring (or not occurring) after the date of issuance of the Series 1997 Bonds may adversely affect the value of, or the tax status of interest on, the Series 1997 Bonds. Further, no assurance can be given that pending or future legislation or amendments to the Code, if enacted into law, or any proposed legislation or amendments to the Code will not adversely affect the value of, or the tax status of interest on, the Series 1997 Bonds. Prospective Series 1997 Bondholders are urged to consult their own tax advisors with respect to proposals to restructure the federal income tax.

Certain requirements and procedures contained or referred to in the Indenture, the Installment Purchase Agreement, the Tax Certificate and other relevant documents may be changed and certain actions (including, without limitation, defeasance of the Series 1997 Bonds) may be taken or omitted under the circumstances and subject to the terms and conditions set forth in such documents. Co-Bond Counsel express no opinion as to any Series 1997 Bond or the interest thereon if any such change occurs or action is taken upon the advice or approval of bond counsel other than Orrick, Herrington & Sutcliffe LLP and Lofton, De Lancie & Nelson.

Although Co-Bond Counsel is of the opinion that interest on the Series 1997 Bonds is excluded from gross income for federal income tax purposes and is exempt from State of California personal income taxes, the ownership or disposition of, or the accrual or receipt of interest on, the Series 1997 Bonds may affect an owner's federal or state tax liability. The nature and extent of these other tax consequences will depend upon the particular tax status of the Bondholder or the Bondholder's other items of income or deduction. Co-Bond Counsel express no opinion regarding any such other tax consequences.

INDEPENDENT ACCOUNTANTS

The financial statements of the Sewer Revenue Fund for the fiscal years ended June 30, 1996 and 1995, attached hereto as Appendix A to this Official Statement have been audited by Calderon, Jaham & Osborn, independent accountants, as set forth in their report, dated November 8, 1996.

RATINGS

Moody's Investors Service and Standard & Poor's Ratings Group have assigned ratings of "Aaa" and "AAA," respectively, to the Series 1997 Bonds based upon the issuance of the Policy by Financial Guaranty. See "SECURITY FOR THE SERIES 1997 BONDS - Bond Insurance." Such ratings reflect only the views of such organizations and any desired explanation of the significance of such ratings should be obtained from the rating agency furnishing the same, at the following addresses: Moody's Investors Service, Inc., 99 Church Street, New York, New York 10007; and Standard & Poor's Ratings Group, 25 Broadway, New York, New York 10004. Such ratings are not a recommendation to buy, sell or hold the Series 1997 Bonds. Generally, a rating agency bases its rating on the information and materials furnished to it and on investigations, studies and assumptions of its own. There is no assurance that such ratings will continue for any given period of time or that such ratings will not be revised downward or withdrawn entirely by the rating agencies, if in the judgment of such rating agencies, circumstances warrant. Any such downward revision or withdrawal of such ratings may have an adverse effect on the market price or marketability of the Series 1997 Bonds. The Authority and the City assume no responsibility either to notify the owners of any proposed change in or withdrawal of any such rating subsequent to the date hereof, or to contest any such revision or withdrawal.

FINANCIAL ADVISOR

Public Resources Advisory Group, New York, New York has acted as financial advisor to the City in connection with the issuance of the Series 1997 Bonds. The Financial Advisor is not obligated to undertake, and has not undertaken to make, an independent verification or assume responsibility for the accuracy, completeness, or fairness of the information contained in this Official Statement.

CERTAIN LEGAL MATTERS

Legal matters incident to the authorization and issuance of the Series 1997 Bonds are subject to the approval of Orrick, Herrington & Sutcliffe LLP, Los Angeles, California and Lofton, De Lancie & Nelson, San Francisco, California, Co-Bond Counsel. The form of opinions Co-Bond Counsel propose to render is attached as Appendix E. Co-Bond Counsel undertake no responsibility for the accuracy, completeness or fairness of this Official Statement. Certain legal matters are subject to the approval of Curls, Brown & Roushon, Los Angeles, California, Underwriters' Counsel, Casey Gwinn, Esq., the City Attorney of the City of San Diego and General Counsel to the Authority and Orrick, Herrington & Sutcliffe LLP, Los Angeles, California, Disclosure Counsel.

LITIGATION

There is no litigation pending concerning the validity of the Series 1997 Bonds, the corporate existence of the City or the Authority, or the title of the officers to their respective offices.

UNDERWRITING

The Series 1997 Bonds are to be purchased by Smith Barney Inc., PaineWebber Incorporated, BancAmerica Securities, Inc. and Artemis Capital Group, Inc., as Underwriters, at a price which includes an underwriters' discount of \$1,120,569. The Underwriters are committed to purchase all the Series 1997 Bonds if any are purchased. The Underwriters may offer and sell the Series 1997 Bonds to certain dealers (including depositing the Series 1997 Bonds into investment trusts) and others at prices lower than the offering prices stated on the inside cover of this Official Statement. After the initial public offering, the public offering prices of the Series 1997 Bonds may be changed from time to time by the Underwriters.

CONTINUING DISCLOSURE

The Authority has determined that no financial or operating data concerning the Authority is material to an evaluation of the offering of the Series 1997 Bonds or to any decision to purchase, hold or sell the Series 1997 Bonds and the Authority will not provide any such information. The City has undertaken all responsibilities for any continuing disclosure to Bondholders as described below, and the Authority shall have no liability to the Bondholders of the Series 1997 Bonds or any other person with respect to S.E.C. Rule 15c2-12.

The City has covenanted for the benefit of Bondholders and beneficial owners of the Series 1997 Bonds to provide certain financial information and operating data relating to the City by not later than 270 days following the end of the City's fiscal year (which fiscal year currently ends June 30) (the "Annual Report"), commencing with the report for the 1996-97 fiscal year, and to provide notices of the occurrence of certain enumerated events, if material. The Annual Report will be filed by the Trustee, as the initial dissemination agent (the "Dissemination Agent") on behalf of the City with each Nationally Recognized Municipal Securities Information Repository and the State Repository, if any. The notices of material events will be filed by the Dissemination Agent on behalf of the City with the Municipal Securities Rulemaking Board, each Nationally Recognized Municipal Securities Information Repository and the State Repository, if any. The specific nature of the information to be contained in the Annual Report or the notices of material events is summarized below under the caption "APPENDIX D - SUMMARY OF PRINCIPAL LEGAL DOCUMENTS - Continuing Disclosure Agreement." These covenants have been made in order to assist the Underwriters in complying with S.E.C. Rule 15c2-12(b)(5). The City has never failed to comply in all material respects with any previous undertakings with regard to said Rule to provide annual reports or notices of material events.

AVAILABILITY OF DOCUMENTS

Copies of the Official Statement, the Indenture, the Installment Purchase Agreement, the Continuing Disclosure Agreement, the City Charter, the Sewer Revenue Fund audited financial statements and additional information relating to the City and the Series 1997 Bonds will be available, upon written request, from the office of the City Clerk, City Administration Building, 202 C Street, MS 2A, San Diego, California 92101. Additional copies of the Official Statement will be made available upon request from the Financial Advisor, c/o Public Resources Advisory Group, 40 Rector Street, New York, New York 10006, (212) 566-7800.

MISCELLANEOUS

The purpose of this Official Statement is to supply information to prospective buyers of the Series 1997 Bonds. References are made herein to certain documents and reports that are brief summaries thereof that do not purport to be complete or definitive, and reference is made to such documents and reports for full and complete statement of the contents thereof.

Any statements in this Official Statement involving matters of opinion, whether or not expressly so stated, are intended as such and not as representations of fact. This Official Statement is not to be construed as a contract or agreement between the City and the purchasers or holders of any of the Series 1997 Bonds. The preparation and distribution of this Official Statement have been authorized by the Authority.

PUBLIC FACILITIES FINANCING AUTHORITY
OF THE CITY OF SAN DIEGO

By: 
Chairman

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APPENDIX A

AUDITED FINANCIAL STATEMENTS

OF THE

SEWER UTILITY

FOR YEARS ENDED JUNE 30, 1996 AND JUNE 30, 1995

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CALDERON, JAHAM & OSBORN

AN ACCOUNTANCY CORPORATION

CERTIFIED PUBLIC ACCOUNTANTS & CONSULTANTS

San Diego • El Centro • Brawley

INDEPENDENT AUDITORS' REPORT

The Honorable Mayor, City Council
and City Manager of the
City of San Diego, California

We have audited the accompanying financial statements of the City of San Diego Sewer Utility as of June 30, 1996 and 1995 and for the years then ended, listed as Exhibits A, B and C in the foregoing table of contents. These financial statements are the responsibility of the City of San Diego management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note 1 to the financial statements, the financial statements referred to above present only the Sewer Utility Enterprise fund of the City of San Diego and are not intended to present the financial position of the City of San Diego, California and results of its operations and the cash flows of its proprietary and similar trust fund types, in conformity with generally accepted accounting principles.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the City of San Diego Sewer Utility at June 30, 1996 and 1995 and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued a report dated November 8, 1996 on our consideration of the City of San Diego's internal control structure and a report dated November 8, 1996 on its compliance with laws and regulations.

The supplemental information included as Exhibit E, Schedule of Allocation for Billing to Metropolitan System Sewer Utility (the "Schedule") has been subjected to the auditing procedures applied in the audit of the basic financial statements. In our opinion, such schedule presents fairly, in all material respects, the allocable costs of the Sewer Utility of the City of San Diego, California for the year ended June 30, 1996, in conformity with various criteria specified in each contract with participating agencies.

The scope of our audits did not include the supplemental information listed as Exhibits D and F, Schedules and Tables listed in the foregoing table of contents. Such information has not been subjected to the auditing procedures applied in the audits of the basic financial statements and, accordingly, we express no opinion on it.

November 8, 1996

Calderon, Gaham & Osborn

Sewer Utility

BALANCE SHEETS, JUNE 30, 1996 AND 1995

	June 30	
	1996	1995
ASSETS		
UTILITY PLANT:		
Sewerage Plant in Service.....	\$532,918,311	\$502,965,310
Construction Work in Process.....	1,037,792,677	752,495,337
Total.....	1,570,710,988	1,255,460,647
Less Accumulated Depreciation.....	152,464,107	139,505,123
TOTAL UTILITY PLANT - NET.....	1,418,246,881	1,115,955,524
ADVANCES TO CITY OF SAN DIEGO INTERNAL SERVICE FUNDS (Note 4).....	8,805,674	7,657,854
CONSTRUCTION GRANTS RECEIVABLE.....	13,366,285	13,256,250
RESTRICTED ASSETS - BOND INTEREST AND REDEMPTION FUNDS:		
Cash with Custodian (Note 2).....	47,446	170,518
TOTAL RESTRICTED ASSETS.....	47,446	170,518
DEFERRED CHARGES.....	14,896,470	6,500,597
CURRENT ASSETS:		
Cash or Equity in Pooled Cash and Investments - Sewer Revenue Fund (Note 2).....	310,855,081	305,120,838
Accrued Interest Receivable.....	3,480,066	3,403,846
Accounts Receivable - Principally from Customers (Less Allowance for Doubtful Accounts of \$1,075,808 and \$1,025,730 Respectively).....	24,251,488	35,614,994
Prepaid Expenses.....	185,485,933	24,314,693
Due from Other Funds.....	9,692,360	15,094,463
TOTAL CURRENT ASSETS.....	533,764,928	383,548,834
TOTAL ASSETS.....	\$1,989,127,684	\$1,527,089,577

See Notes to Financial Statements.

Sewer Utility

EXHIBIT A

	June 30	
	1996	1995
LIABILITIES AND EQUITY		
LONG-TERM DEBT:		
Sewer Revenue Bonds - (Note 3).....		
Installment Purchase Agreement.....	\$588,285,000	\$242,785,000
Loan Payable.....	100,000	100,000
Total.....	588,385,000	242,885,000
Less Due Within One Year.....	4,660,000	4,500,000
TOTAL LONG-TERM DEBT.....	583,725,000	238,385,000
CURRENT LIABILITIES:		
Obligations Under Reverse Repurchase Agreements.....	6,455,436	31,958,054
Accounts Payable.....	45,610,356	30,580,552
Accrued Payroll.....	1,495,134	1,074,679
Accrued Annual Leave and Sick Leave.....	3,709,727	3,371,752
Accrued SPSP Contributions Payable.....	92,396	82,894
Due to Other Funds.....	0	500,000
Liability Claims.....	1,858,113	4,851,368
Matured Long-Term Debt.....	47,446	119,727
Interest Matured on Long-Term Debt.....	0	50,791
Interest Accrued on Long-Term Debt.....	3,637,838	1,477,245
Long-Term Debt Due Within One Year.....	4,660,000	4,500,000
TOTAL CURRENT LIABILITIES.....	67,566,446	78,567,062
DEFERRED CREDITS:		
Deferred Contributions in Aid of Construction.....	475,844	225,082
Metropolitan Sewer Capacity Service Charge.....	338,870	386,152
Deferred Developers Deposits.....	11,889,713	4,782,070
Deferred Credit Metropolitan Agencies.....	32,511,597	18,061,544
TOTAL DEFERRED CREDITS.....	45,216,024	23,454,848
TOTAL LIABILITIES.....	696,507,470	340,406,910
COMMITMENTS AND CONTINGENCIES (Notes 3 and 7)		
EQUITY:		
Contributions in Aid of Construction:		
Federal.....	155,706,761	122,901,073
State.....	21,852,071	21,578,295
Municipal.....	42,777,166	42,390,993
Local.....	9,476,799	9,476,799
Developers.....	294,160,003	275,808,197
Capacity Charge.....	196,389,787	183,864,492
Other.....	18,861,862	18,861,862
Total Contributions in Aid of Construction.....	739,224,449	674,881,711
Retained Earnings:		
Invested in Assets of the System.....	496,486,098	474,749,992
Rate Stabilization Reserve.....	10,000,000	0
Designated for Future Years' Capital Projects and Operations.....	46,909,667	37,050,964
Total Retained Earnings.....	553,395,765	511,800,956
TOTAL EQUITY.....	1,292,620,214	1,186,682,667
TOTAL LIABILITIES AND EQUITY.....	\$1,989,127,684	\$1,527,089,577

Sewer Utility

STATEMENTS OF INCOME AND RETAINED EARNINGS FOR THE YEARS ENDED JUNE 30, 1996 AND 1995

EXHIBIT B

	Year Ended June 30	
	1996	1995
OPERATING REVENUES:		
Sewer Service Charges:		
Inside City:		
Domestic.....	\$96,113,508	\$95,333,742
Commercial and Industrial.....	38,460,649	37,832,852
Outside City:		
Domestic, Commercial and Industrial.....	10,151	9,270
Treatment Plant Service for Others	32,920,667	32,271,388
Total Sewer Service Charges.....	167,504,975	165,447,252
Other Operating Revenues:		
Operating Grants.....	426,175	312,234
Miscellaneous (Net).....	1,017,445	188,111
TOTAL OPERATING REVENUES.....	168,948,595	165,947,597
OPERATING EXPENSES (Note 4).....	122,983,712	118,354,527
OPERATING INCOME.....	45,964,883	47,593,070
NONOPERATING REVENUES (EXPENSES):		
Interest Income (Note 2).....	16,834,747	16,459,340
Gain (Loss) on Sale/Retirement of Fixed Assets.....	(2,591,703)	(32,027,997)
Interest Expense - Installment Purchase Agreement (Note 3).....	(19,928,687)	(12,467,426)
Financing Costs Under Installment Purchase Agreement.....	(529,683)	(232,165)
Reverse Repurchase Agreement Interest Expense	(1,113,892)	(2,529,402)
Non-Operating Grants.....	14,673,091	0
Other.....	(9,149,987)	1,534,499
TOTAL NONOPERATING REVENUES (EXPENSES).....	(1,806,114)	(29,263,151)
Operating Transfer In.....	173,040	80,896
Operating Transfer Out.....	(637,000)	(500,000)
Transfers To Governmental Funds.....	(2,100,000)	(914,104)
NET INCOME.....	41,594,809	16,996,711
Retained Earnings at Beginning of Year.....	511,800,956	494,804,245
RETAINED EARNINGS AT END OF YEAR.....	\$553,395,765	\$511,800,956

See Notes to Financial Statements.

Sewer Utility

STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED JUNE 30, 1996 AND 1995

EXHIBIT C

	Year Ended June 30	
	1996	1995
CASH FLOWS FROM OPERATING ACTIVITIES		
Operating Income (Loss).....	\$45,964,883	\$47,593,070
Adjustments to Reconcile Operating Income (Loss) to Net Cash Provided By (Used For) Operating Activities:		
Depreciation and Amortization.....	10,966,857	10,058,635
Changes in Assets and Liabilities:		
(Increase) Decrease in Accounts Receivable.....	11,363,506	(11,177,623)
(Increase) Decrease in Prepaid and Reimbursable Items and Deposits.....	24,887	(81,585)
Increase (Decrease) in Accounts Payable.....	15,029,804	23,020,489
Increase (Decrease) in Accrued Payroll.....	420,455	(1,039,203)
Increase (Decrease) in Accrued Annual Leave and Sick Leave.....	337,975	504,088
Increase (Decrease) in Accrued SPSP Contributions Payable.....	9,502	(68,703)
Increase (Decrease) in Due to Other Funds.....	(500,000)	(500,000)
Increase (Decrease) in Liability Claims.....	(2,993,255)	1,829,895
Increase (Decrease) in Deferred Revenue.....	21,761,176	10,753,293
Other Nonoperating Revenue.....	(9,149,987)	1,534,499
NET CASH PROVIDED BY (USED FOR) OPERATING ACTIVITIES.....	93,235,803	82,426,855
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Operating Transfers In (Out) to Other Funds.....	(463,960)	(419,104)
Transfers from (to) Governmental Funds.....	(2,100,000)	(914,104)
Operating Grants.....	(110,035)	(3,559,021)
Proceeds from (Payments for) Advances and Deposits.....	(1,147,820)	(773,622)
NET CASH PROVIDED BY (USED FOR) NONCAPITAL FINANCING ACTIVITIES.....	(3,821,815)	(5,665,851)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from Installment Purchase Agreement.....	185,810,103	55,135,022
Proceeds from Contributed Capital.....	45,989,544	44,464,968
Proceeds from Non-Operating Grants.....	14,673,091	0
Acquisition of Fixed Assets.....	(297,496,761)	(186,501,113)
Proceeds from Sale of Fixed Assets.....	38	0
Principal Paid on Long-Term Debt.....	(4,572,281)	(4,914,058)
Interest Paid on Long-Term Debt.....	(18,348,568)	(10,995,028)
NET CASH PROVIDED BY (USED FOR) CAPITAL AND RELATED FINANCING ACTIVITIES.....	(73,944,835)	(102,810,209)
CASH FLOWS FROM INVESTING ACTIVITIES		
Net (Purchases) Sales of Investments.....	(25,502,618)	(9,939,902)
Interest and Dividends Received on Investments.....	16,758,527	15,786,607
Reverse Repurchase Agreement Interest Paid.....	(1,113,892)	(2,529,402)
NET CASH PROVIDED BY (USED FOR) INVESTING ACTIVITIES.....	(9,857,983)	3,317,303
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS.....	5,611,171	(22,731,902)
Cash and Cash Equivalents at Beginning of Year.....	305,291,356	328,023,258
CASH AND CASH EQUIVALENTS AT END OF YEAR.....	\$310,902,527	\$305,291,356

See Notes to Financial Statements.

Sewer Utility

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED JUNE 30, 1996

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Sewer Utility is included in the administrative organization of the City of San Diego (the "City"); its financial information and records are established and maintained by the City.

The accounting policies of the Sewer Utility conform to Generally Accepted Accounting Principles ("GAAP") as applicable to governmental units. The following is a summary of the more significant of such policies:

a. Basis of Presentation

The financial activities of the Sewer Utility are accounted for and reported as an Enterprise Fund of the City. The measurement focus is upon determination of net income, financial position and changes in cash flows.

Enterprise Funds are used to account for operations (a) that are financed and operated in a manner similar to private business enterprises-where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability or other purposes.

The Sewer Utility adopts all FASB statements and interpretations issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

b. Basis of Accounting

The Sewer Utility uses the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned, and expenses are recorded when incurred. Estimated unbilled revenues are recognized at the end of each fiscal year. This estimated amount is based on billings during the month following the close of the fiscal year.

c. Utility Plant

Utility plant in service and land are stated at estimated cost based on amounts appraised on July 1, 1959, plus subsequent additions generally at cost or, in the case of contributions in aid of construction, at cost or appraised value at the date of contribution. The utility plant is depreciated by the straight-line method over estimated useful lives of five to seventy-five years.

d. Employee Annual Leave

The Sewer Utility provides combined annual leave to cover both vacation and sick leave. It is the Sewer Utility's policy to permit employees eligible for the Management Benefits Plan to accumulate up to 17.5 weeks of earned but unused annual leave and all other employees to accumulate up to 15 weeks of earned but unused annual leave. Accumulation of these earnings will be paid to employees upon separation from service. Excess accumulated annual leave amounts not used by employees are forfeited on an annual basis.

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In addition, sick leave earned through August 1981 by employees hired prior to July 1, 1975 is payable upon separation under the following conditions: 1) 50% of the employee's accrued amount upon retirement or death, or 2) 25% of the employee's accrued amount upon resignation. Annual leave benefits are recorded as a liability in the period earned by the employee.

e. Claims and Judgments

Costs of claims and judgments are recorded when the liability is incurred and measurable.

f. Contributions in Aid of Construction

Additions to contributions in aid of construction (approximately \$60,999,000 in 1996 and \$63,964,000 in 1995) represents facilities or cash contributed for facility construction by property owners or government agencies. Cash contributions in aid of construction for meters and service are classified as deferred credits until the facilities have been installed.

g. Statement of Cash Flows

All of the Sewer Utility's "Cash with Custodian" and "Cash or Equity in Pooled Cash and Investments" are classified as cash and cash equivalents.

h. Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of certain asset and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the related reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Management believes that the estimates are reasonable.

2. CASH AND INVESTMENTS

a. Cash with Custodian

Cash with Custodian represents funds held by a bank trustee on behalf of the Sewer Utility for the payment of principal and interest to bondholders. Since such cash is held by the bank's trust department, it is not covered by federal depository insurance or collateralized by securities owned by the bank.

b. Cash or Equity in Pooled Cash and Investments

Other cash resources of the Sewer Utility are combined with the cash resources of the City to form a pool of cash that is managed by the City Treasurer. As provided for by the Government Code, the cash balance of substantially all City funds and certain entities are pooled and invested by the City Treasurer for the purpose of increasing interest earnings through investment activities. The Sewer Utility's net share of the total pooled cash and investments is included in the accompanying balance sheet under the captions "Cash or Equity in Pooled Cash and Investments" and "Obligations under Reverse Repurchase Agreements". Interest earned on pooled investments is deposited to certain of the participating City funds and entities, including the Sewer Utility, based upon each fund's and each entity's average daily deposit balance during the allocation period with all remaining interest deposited to the City's General Fund.

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The City may transact business only with banks, savings and loans, and investment securities dealers who are primary dealers regularly reporting to the New York Federal Reserve Bank. Exceptions to this rule can be made only upon written authorization of the City Treasurer. Authorized cash deposits and investments are governed by state law, as well as by the City's own written investment policy. Within the context of these limitations, permissible investments include (1) obligations of the U.S. government and federal agencies, (2) commercial paper rated A-1 by Standard & Poor's Corporation or P-1 by Moody's Commercial Paper Record, (3) bankers' acceptances, (4) negotiable and/or non-negotiable certificates of deposit and non-negotiable time deposits issued by a nationally or state chartered bank or a state or federal savings and loan association, (5) repurchase and reverse repurchase agreements, (6) the local agency investment fund established by the state treasurer and (7) financial futures contracts in any of the other authorized investments which are used to offset an existing financial position and not for outright speculation.

c. Reverse Repurchase Agreements

Investment policies permit the City to enter into reverse repurchase agreements which is a sale of securities with a simultaneous agreement to repurchase them in the future at the same price plus a contract rate of interest. The market value of the securities underlying reverse repurchase agreements normally exceeds the cash received providing the dealers a margin against a decline in the market value of the securities. If the dealers default on their obligations to resell these securities to the City or provide securities of cash or equal value, the City could suffer an economic loss equal to the difference between the market value plus accrued interest of the underlying securities and the reverse repurchase agreement obligation, including accrued interest payable. There was no such credit exposure at year-end. Interest expense was incurred under reverse repurchase agreements in the amount of \$1,113,892 for the year ended June 30, 1996.

Deposits and investments are generally exposed to two types of risk: credit risk and market risk. Credit risk is the risk that a governmental entity will not be able (a) to recover deposits if the depository financial institution fails or (b) to recover the value of investment or collateral securities that are in the possession of an outside party if the counterparty to the investment or deposit transaction fails. Market risk is the risk that the value of an investment will decline.

In accordance with governmental reporting standards, the Sewer Utility has classified its deposits and investments by categories of credit risk. Classification in category 1 indicates that the exposure to potential credit risk is low. The level of potential credit risk is higher for those classified in category 2, and highest for those in category 3.

Deposits may be categorized as follows: (1) Insured or collateralized with securities held by the entity or by its agent in the entity's name, (2) Collateralized with securities held by the pledging financial institution's trust department or agent in the entities name, (3) Uncollateralized.

Investments may be categorized as follows: (1) Insured or registered, or securities held by the entity or its agent in the entity's name, (2) Uninsured and unregistered, with securities held by the counterparty's trust department or agent in the entity's name, (3) Uninsured and unregistered, with securities held by the counterparty, or by its trust department or agent but not in the entity's name.

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Aggregate cash with custodian and cash or equity in pooled cash and investments are as follows at June 30, 1996:

	<u>Total</u>
Cash or Equity in Pooled Cash and Investments	\$310,855,081
Cash with Custodian	<u>47,446</u>
Total	<u>\$310,902,527</u>

Information pertaining to the City's cash and investment pool may be found in the City's Comprehensive Annual Financial Report.

The Sewer Utility's cash and investments at June 30, 1996, that can be specifically identified as to credit risk are categorized below:

	<u>Category</u>			<u>Carrying Amount</u>	<u>Bank Balance/Market Value</u>
	<u>1</u>	<u>2</u>	<u>3</u>		
<u>Deposits</u>					
Uninsured and Uncollateralized	<u>\$ -0-</u>	<u>\$ -0-</u>	<u>\$ 47,446</u>	<u>\$ 47,446</u>	<u>\$ 47,446</u>

3. LONG-TERM DEBT

Long-term debt as of June 30, 1996 and 1995 is comprised of the following:

<u>Type of Obligation</u>	<u>Interest Rates</u>	<u>Maturity Date</u>	<u>Original Amount</u>	<u>Balance Outstanding</u>	
				<u>June 30, 1996</u>	<u>June 30, 1995</u>
Installment Purchase Agreement Payable, 1995	3.95-5.31	2025	\$350,000,000	\$350,000,000	\$ 0
Installment Purchase Agreement Payable, 1993	2.8-5.25	2023	250,000,000	238,285,000	242,785,000
Loan Payable to County of San Diego	0	N/A	<u>100,000</u>	<u>100,000</u>	<u>100,000</u>
Total Long-Term Debt			<u>\$600,100,000</u>	<u>\$588,385,000</u>	<u>\$242,885,000</u>

Sewer Utility

The following is a summary of changes in general long-term debt for the year ended June 30, 1996.

	Balance July 1, 1995	Additions	Retirements	Balance June 30, 1996
Installment Purchase Agreement Payable, 1995	\$ 0	\$350,000,000	\$0	\$350,000,000
Installment Purchase Agreement Payable, 1993	242,785,000	0	4,500,000	238,285,000
Loan Payable to County of San Diego	<u>100,000</u>	<u>0</u>	<u>0</u>	<u>100,000</u>
Total	<u>\$242,885,000</u>	<u>\$350,000,000</u>	<u>\$4,500,000</u>	<u>\$588,385,000</u>

Annual requirements to amortize long-term debt as of June 30, 1996, including interest payments to maturity are as follows:

Year Ending June 30,	Installment Purchase Agreement
1997	\$ 33,762,710
1998	39,899,611
1999	39,899,400
2000	39,904,200
2001	39,903,760
Thereafter	<u>925,013,897</u>
Total	1,118,383,578
Less - Amounts representing interest	<u>(530,098,578)</u>
Net Installment Purchase Agreement	<u>\$ 588,285,000</u>

The City has an installment purchase agreement with the Public Facilities Financing Authority "Authority" for the acquisition, construction, installation, and improvement of its wastewater system. The Authority obtained financing for the project through the issuance of bonds secured by installment payments made to the Authority by the City. The City has pledged revenues from its wastewater system to finance these installment payments in an amount equal to the principal and interest requirements of the associated bonds.

4. TRANSACTIONS WITH THE CITY OF SAN DIEGO

The Sewer Utility has financed the acquisition by the City's Internal Service Funds of certain vehicles and supplies used by the Sewer Utility. The Internal Service Funds charge the Sewer Utility for the use of the vehicles and supplies. However, there is no specific provision for the repayment of these advances or interest on them. It is the City's general intent that the advances be repaid as the financial condition of the Internal Service Funds permit. Some repayments have been made in prior years. Included in operating

Sewer Utility

expenses is approximately \$3,599,000 in 1996 and \$3,504,000 in 1995 charged by the City to the Sewer Utility for indirect general government expenditures incurred by the City. Such charges are based on a pro-rata portion of indirect general government expenditures applicable to the Sewer Utility.

A portion of the utility plant, known as the Metropolitan Sewer System, was financed through a Federal grant. The grant was made to the Sewer Utility and participating cities and sanitation districts served by the System. Grant funds received by the Sewer Utility through participating agencies pay the Sewer Utility for contracted capacity rights and share in the maintenance and operating costs.

The Sewer Utility provides sewer services to the City at commercial rates. Such revenues were approximately \$800,000 in 1996 and \$451,000 in 1995.

The Sewer Utility paid approximately \$11,012,000 in 1996 and \$6,388,148 in 1995 for computer services provided by the San Diego Data Processing Corporation, a non-profit corporation, of which the City is the sole member.

The Sewer Utility paid \$8,310,900 in 1996 and \$5,550,000 in 1995 to the city for right-of-way impact assessment charges for the use of public rights of way for sewage collection systems.

5. PENSION PLANS

The City has a defined benefit plan and various defined contribution pension plans covering substantially all of its employees.

DEFINED BENEFIT PLAN

a. Plan Description

All of the City and the San Diego Unified Port District (the "District") full-time employees participate in the City Employees' Retirement System ("CERS"), an agent multiple-employer public employee retirement system that acts as a common investment and administrative agent for the City and the District. For the year ended June 30, 1996, the City's payroll for employees covered by CERS was approximately \$355,735,000 while the City's total payroll was approximately \$398,853,000.

The number of City and District employees and covered membership are as follows:

Retiree and beneficiaries currently receiving benefits and terminated employees not yet receiving benefits	4,166
Fully vested active employees	3,543
Non-vested active employees	6,086

All full-time City employees are eligible to participate in CERS. Retirement benefits are determined primarily by the member's age at retirement, the length of membership service and the member's final compensation. Final compensation is the members' compensation earnable based on the highest one-year period. Benefits fully vest on reaching 10 years of service. CERS also provides death and disability benefits. Benefits are established by the City's Municipal Code.

City employees are required to contribute a percentage of their annual salary to CERS. The City is required to contribute the remaining amounts necessary to fund CERS, using the actuarial basis specified by statute.

b. Funding Status and Progress

The amount shown below as the "pension benefit obligation" is a standardized disclosure measure of the

Sewer Utility

b. Funding Status and Progress

The amount shown below as the "pension benefit obligation" is a standardized disclosure measure of the present value of pension benefits, adjusted for the effects of projected salary increases and step-rate benefits, estimated to be payable in the future as a result of employee service to date. The measure is intended to help users assess the funding status of CERS on a going-concern basis, assess progress made in accumulating sufficient assets to pay benefits when due, and make comparisons among employers. The measure is the actuarial present value of credited projected benefits, and is independent of the funding method used to determine contributions to CERS.

The pension benefit obligation was computed as part of an actuarial valuation performed as of June 30, 1995. Significant actuarial assumptions used in the valuation include: (a) a rate of return on the investment of present and future assets of 8% a year compounded annually; (b) projected salary increases of 5.0% a year compounded annually (0.5% due to merit and 4.5% due to inflation); (c) up to a 4.5% per annum cost of living assumption; and (d) the Group Annuity Mortality Table with a 2 year setback for males and an 8 year setback for females.

Accumulated benefits and net assets for the City's defined benefit plan as of June 30, 1995, the most recent actuarial valuation date, are as follows (in thousands):

Pension benefit obligation:	
Retirees and beneficiaries currently receiving benefits and terminated employees not yet receiving benefits	\$ 662,592
Current employees:	
Accumulated employee contributions including allocated investment earnings	184,690
Employer-financed vested	500,987
Employer-financed Non-vested	<u>128,441</u>
Total pension benefit obligation	1,476,710
Net assets available for benefits at cost	<u>(1,281,266)</u>
Unfunded pension benefit obligation	<u>\$ 195,444</u>

The market value of the net assets was approximately \$1,385,851,000 at June 30, 1995.

c. Actuarially Determined Contribution Requirements and Contribution Made

Contributions to CERS from City employees vary according to entry age and salary. The City contributes a portion of the employees' share and the remaining amount necessary to fund the system based on an actuarial valuation at the end of the preceding year under the entry age normal cost method. The entry age normal cost method defines the normal cost as the level percent of payroll needed to fund benefits over the period from the date of participation to the date of retirement. Beginning with the June 30, 1992 valuation, contributions are based on the projected unit credit method of actuarial valuation. Initial prior service costs are being amortized over a period of 30 years. Additional prior service costs due to plan changes in 1965 are being amortized over 30 years.

The significant actuarial assumptions used to compute the actuarially determined contribution requirement are the same as those used to compute the pension benefit obligation as described above.

Sewer Utility

The City's contribution to CERS for 1996 of approximately \$59,145,000 (16.6% of current covered payroll) was made in accordance with actuarially determined requirements computed through an actuarial valuation performed as of June 30, 1994. The contribution consisted of (a) \$47,335,000 normal cost (13.3% of current covered payroll), and (b) \$11,810,000 amortization of the unfunded actuarial accrued liability (3.3% of current covered payroll). The City contributed \$45,436,000 (12.8% of covered payroll); employees contributed \$15,424,000 (4.3% of covered payroll).

d. Trend Information

Trend information gives an indication of the progress made in accumulating sufficient assets to pay benefits when due. Ten-year trend information may be found on page 19 of the City's Comprehensive Annual Financial Report. For the three fiscal years ended 1993, 1994 and 1995 respectively, available assets were sufficient to fund 90.3, 88.5 and 86.8% of the City's pension benefit obligation. Unfunded pension benefit obligation represented 34.9, 42.8 and 52.4% of the City's annual payroll for employees covered by CERS for 1993, 1994 and 1995 respectively. Showing unfunded pension benefit obligation as a percentage of annual covered City payroll approximately adjusted for the effects of inflation for analysis purposes. In addition, for the three fiscal years ended 1993, 1994 and 1995 the City's contributions to CERS, all made in accordance with actuarially determined requirements, were 10.0, 10.3 and 10.9% respectively of annual covered payroll.

Plan data for the plan year ended June 30, 1996 is not yet available.

DEFINED CONTRIBUTION PLANS

Pursuant to the City's withdrawal from the Federal Social Security System effective January 8, 1982, the City provides pension benefits for eligible full-time employees through a supplemental pension and savings plan, a defined contribution plan. In a defined contribution plan, benefits depend solely on amounts contributed to the plan plus investment earnings. Employees are eligible to participate from the date of employment. State legislation requires that both the employee and the City contribute an amount equal to 3% of the employee's total salary each month. Participants in the plan hired before April 1, 1986 and on or after April 1, 1986 may voluntarily contribute up to an additional 4.5% and 3.05%, respectively, of total salary.

The City also contributes an amount equal to the employee voluntary contributions. The City's contributions for each employee (and interest allocated to the employee's account) are fully vested after five years of continuous service. City contributions for, and interest forfeited by, employees who leave employment before five years of service are used to reduce the City's contribution requirement.

The City's total payroll in Fiscal Year 1996 was approximately \$398,853,000. The City's contributions were calculated using the salary amount of approximately \$255,557,000. The City and the covered employees each contributed approximately \$15,679,000 (6.2%) or approximately \$31,359,000 in total.

In addition, the City provides pension benefits for all eligible full-time employees through the 401(k) Deferred Compensation Plan, also a defined contribution plan. Employees are eligible to participate twelve months after the date of employment. Employees make contributions to their 401(k) accounts through payroll deductions, and may also elect to have the City contribute to their 401(k) accounts through the City's Employees' Flexible Benefits Program.

The City's total payroll in Fiscal Year 1996 was approximately \$398,853,000. The employee's 401K contributions were calculated pursuant to various combination arrangements. The covered employees contributed approximately \$6,170,000.

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6. POST RETIREMENT HEALTH INSURANCE

In addition to providing pension benefits, the City of San Diego Municipal Code provides certain health care insurance benefits for retired general and safety members of CERS who retired on or after October 6, 1980. At June 30, 1996, approximately 1,900 eligible retirees received benefits.

Certain health care insurance benefits were established during Fiscal Year 1995 for eligible retirees who retired prior to October 6, 1980 or who were otherwise not eligible to receive City-paid health care insurance as of June 30, 1994. At June 30, 1996, approximately 1,160 eligible retirees received benefits.

Currently, expenses for post-employment health care benefits are recognized as they are paid. For the fiscal year ended June 30, 1996, expenditures of approximately \$4,949,000 were recognized for such health care benefits.

Substantially all of the City's general and safety members of CERS may become eligible for those benefits if they reach normal retirement age and meet service requirements as defined while working for the City.

7. COMMITMENTS AND CONTINGENCIES

The Sewer Utility's construction plans for various projects are estimated to cost approximately \$199,305,000. As of June 30, 1996, the Utility's contractual commitments for the projects totaled approximately \$104,885,000. The Utility intends to finance the contractual commitments with approved State and Federal grants, service charges and the Installment Purchase Agreement.

The Sewer Utility is self-insured for general liability claims. At June 30, 1996, the Sewer Utility has recorded approximately \$1,858,113 for such claims. These amounts represent the Utility's determination of the probable ultimate cost of the claims.

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NET REVENUE AVAILABLE FOR DEBT SERVICE
FOR THE YEARS ENDED JUNE 30, 1996 AND 1995

EXHIBIT D

UNAUDITED

	Year Ended June 30	
	1996	1995
TOTAL OPERATING REVENUES (Exhibit B)	\$168,948,595	\$165,947,597
OPERATING EXPENSES:		
Transmission.....	33,264,059	31,786,946
Treatment and Disposal Plant.....	39,406,012	44,121,508
Special Projects.....	0	7,492,445
Accounting.....	2,160,301	2,471,754
General and Administrative.....	37,186,483	22,423,239
TOTAL OPERATING EXPENSES	112,016,855	108,295,892
OPERATING INCOME	56,931,740	57,651,705
OTHER INCOME (CHARGES):		
Capital Grant Receipts.....	48,629,476	33,115,894
Operating Transfer In/(Out).....	(2,563,960)	(1,333,208)
Trunk Line Sewer Area Charge.....	0	(73,491)
Capacity Charge Municipal System.....	12,523,907	11,439,060
Interest Income.....	16,834,747	16,459,340
Reverse Repurchase Agreement Interest Expense	(1,113,892)	(2,529,402)
Rate Stabilization.....	(10,000,000)	0
Other Income.....	(9,149,987)	1,534,499
TOTAL OTHER INCOME	55,160,291	58,612,692
NET REVENUE AVAILABLE FOR DEBT SERVICE (As Defined by Bond Ordinance)	\$112,092,031	\$116,264,397

DEBT SERVICE COVERAGE

(Earnings Times Debt Service)

The Principal and Interest Due in Fiscal Year Ending June 30, 1996
(\$24,428,688) Covered..... 4.59

The Principal and Interest Due in Fiscal Year Ending June 30, 1995
(\$16,319,661) Covered..... 7.12

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EXPENSES

EXHIBIT E

ALLOCATION FOR BILLING TO METROPOLITAN SYSTEM
FOR THE YEAR ENDED JUNE 30, 1996

	Operating Expenses			
	Municipal System	Metropolitan System	Clean Water System	Total
TRANSMISSION:				
Cleaning and Stoppage Removals, Mains and Laterals.....	\$863,522	\$0	\$0	\$863,522
Accrued Claims.....	1,858,113	0	0	1,858,113
Maintenance and Laterals.....	762,437	0	0	762,437
Maintenance of Mains and Manholes.....	13,583,623	0	0	13,583,623
Sewage Pumping Stations.....	8,747,932	7,448,432	0	16,196,364
TOTAL TRANSMISSION.....	25,815,627	7,448,432	0	33,264,059
TREATMENT AND DISPOSAL:				
Cogeneration Facilities.....	0	1,369,985	0	1,369,985
Point Loma Plant.....	0	30,328,211	0	30,328,211
Escondido System.....	1,133,047	0	0	1,133,047
Sewage Testing and Control.....	1,967,179	4,607,590	0	6,574,769
TOTAL TREATMENT AND DISPOSAL.....	3,100,226	36,305,786	0	39,406,012
ACCOUNTING SERVICES:				
General Accounting.....	313,502	0	0	313,502
Utility Commercial.....	1,846,799	0	0	1,846,799
TOTAL ACCOUNTING SERVICES.....	2,160,301	0	0	2,160,301
GENERAL, ADMINISTRATIVE AND TAXES:				
Utilities Administration and General Expenses.....	10,997,305	17,987,004	3,388,627	32,372,936
Expenses of Other City Departments Applicable to Sewerage Utility.....	1,182,853	0	1,773,030	2,955,883
Engineering Expenses.....	1,217,013	0	577,918	1,794,931
TOTAL GENERAL, ADMINISTRATIVE AND TAXES.....	13,397,171	17,987,004	5,739,575	37,123,750
TOTAL EXPENSES.....	44,473,325	61,741,222	5,739,575	111,954,122
OVERHEAD ALLOCATION TO CONSTRUCTION (Note 4).....	0	(352,145)	(1,676,023)	(2,028,168)
RECONSTRUCTION AND REPLACEMENT OF NET ALLOCATION (Note 5).....	0	31,600,533	187,839,745	219,440,278
DEBT SERVICE ALLOCATION (Note 6).....	0	947,175	17,398,983	18,346,158
METROPOLITAN SYSTEM INCOME CREDITS (Note 7).....	0	(26,748,398)	(162,385,758)	(189,134,156)
TOTAL ALLOCATION FOR BILLING PURPOSES.....	\$44,473,325	\$67,188,387	\$46,916,522	\$158,578,234

See Notes to Allocation for Billing to Metropolitan System

Sewer Utility

NOTES TO THE ALLOCATION FOR BILLING TO METROPOLITAN SYSTEM SCHEDULE

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The City of San Diego Sewer Utility is a fund of the City of San Diego.

The City of San Diego Sewer Utility operates and maintains the Metropolitan Wastewater System and the Municipal Wastewater Collection System (the "System"). The System operates in the collection and transportation of untreated raw sewage for the City of San Diego, as well as other municipalities and water districts (the "Participating Agencies"). Contractual agreements have been entered into by each Participating Agency with the City of San Diego for their usage and upkeep of the System.

2. BASIS OF PRESENTATION

The accompanying allocation of Billing to Metropolitan System of the Sewer Utility of the City of San Diego, California was prepared for the purpose of determining the total amount to be billed to Participating Agencies for the fiscal year ended June 30, 1996. Generally, the criteria specified in each contract specifies the allowable and unallowable costs that are includable or excludable from the amounts billed.

The Schedule is not intended to be a presentation in conformity with generally accepted accounting principles, nor does it present the financial position or the results of operations of the City of San Diego Sewer Utility or City of San Diego taken as a whole.

3. PARTICIPATING AGENCIES

The Participating Agencies consist of the following municipalities and water districts:

- | | |
|-------------------|-----------------|
| • Chula Vista | • Lemon Grove |
| • Coronado | • National City |
| • Del Mar | • Otay |
| • El Cajon | • Padre Dam |
| • Imperial Beach | • Poway |
| • La Mesa | • Spring Valley |
| • Lakeside/Alpine | • Wintergardens |

4. OVERHEAD ALLOCATION TO CONSTRUCTION

Overhead is included in construction costs based on direct labor charged to the projects. The overhead is reversed out for billing purposes, since administration costs are included in the total allocated costs.

5. RECONSTRUCTION AND REPLACEMENT OF NET ALLOCATION

Construction costs incurred during the fiscal year to maintain and improve the Metropolitan Sewer System and equipment purchases used in the maintenance of the system are included in reconstruction and replacement costs.

6. DEBT SERVICE ALLOCATION

Debt service allocation is that portion of the principal and interest payments relating to the 1993 and 1995 bond

Sewer Utility

issuance.

7. METROPOLITAN SYSTEM INCOME CREDITS

Metropolitan system income credits are revenues earned by the Metropolitan and Clean Water Systems for which costs have been incurred during the current or previous fiscal years. Income credits also include contributions in aid of construction received from federal and state granting agencies and reimbursements from bond proceeds.

8. TOTAL ALLOCATION FOR BILLING PURPOSES

Costs billable are determined by percentage of individual construction projects and operation and maintenance expenses allocable to the Participating Agencies. Total costs are then allocated based on percentage of metered sewage flows.

Sewer Utility

CHANGES IN FUNDS AVAILABLE FOR APPROPRIATION FOR THE YEAR ENDED JUNE 30, 1996

EXHIBIT F

UNAUDITED

Funds Available for Appropriation at July 1, 1995.....	\$0
Add:	
Cash Receipts (Schedule F-1).....	429,189,929
Anticipated Contributions from Other Agencies at June 30, 1996.....	51,417,537
Accrued Annual Leave and Sick Leave at July 1, 1995.....	3,371,752
Operating Reserve at June 30, 1995.....	13,628,228
Emergency Reserve at June 30, 1995.....	5,000,000
Continuing Appropriations at July 1, 1995.....	42,640,777
Continuing Appropriations Encumbered at July 1, 1995.....	158,740,118
Designated for Subsequent Years' Capital Projects and Operations at June 30, 1995.....	35,824,388
Prior Years' Encumbrances Cancelled.....	<u>4,395,103</u>
Total Balances and Additions.....	<u>744,207,832</u>
Deduct:	
Expenditures and Encumbrances (Schedule F-2).....	547,199,501
Anticipated Contributions from Other Agencies at July 1, 1995.....	25,715,678
Accrued Annual Leave and Sick Leave at June 30, 1996.....	3,709,727
Operating Reserve at June 30, 1996.....	16,513,621
Emergency Reserve at June 30, 1996.....	5,000,000
Rate Stabilization Reserve at June 30, 1996.....	10,000,000
Designated for Subsequent Years' Capital Projects and Operations at June 30, 1996.....	46,909,667
Continuing Appropriations at June 30, 1996.....	<u>89,159,638</u>
Total Deductions.....	<u>744,207,832</u>
FUNDS AVAILABLE FOR APPROPRIATION AT JUNE 30, 1996.....	<u>\$0</u>

The Sewer Revenue Fund (Municipal Code Sec. 64.31) is used to account for the receipts, expenditures, and revenue derived from operation of the sewer system of the Water Utilities Department. The Charter, Sec. 90.2 Sub. 8B, provides that "all revenues shall be paid into the Sewer Revenue Fund and shall be used for the following purposes: (1) paying the cost of maintenance and operation of the sewer system; (2) paying principal and interest (including payments into any reserve or sinking fund) and premiums, if any, upon redemption, of sewer revenue bonds issued under this section and payable from said Sewer Revenue Fund; (3) paying all or any part of the cost and expense of extending, reconstructing, or improving the sewer system or any part thereof or making additions to such system; (4) transferring from any surplus in the Sewer Revenue Fund to the Capital Outlay Fund, at one time or from time-to-time, all or any part of the sums expended from said Capital Outland Fund after July 1, 1960, for any purpose for which revenue bonds may be issued under this section; (5) paying from any surplus in the Sewer Revenue Fund principal or interest, or both, or any part thereof, of general obligation bonds heretofore or hereafter issued for any purpose for which revenue bonds may be issued under this section."

Sewer Utility

CHANGES - PLANT IN SERVICE
FOR THE YEAR ENDED JUNE 30, 1996

SCHEDULE A-1

UNAUDITED

	Balance at July 1, 1995	Additions	Retirements	Balance at June 30, 1996
MUNICIPAL SEWERAGE SYSTEM:				
Land and Land Rights:				
Sewer Mains.....	\$512,148	\$0	\$0	\$512,148
Pumping Systems.....	2,319,379	0	0	2,319,379
Treatment and Disposal.....	467	0	0	467
Sewer Service Laterals.....	57,244,352	2,539,186	125	59,783,413
Sewer Mains.....	330,160,358	19,311,579	33,958	349,437,979
Meters and Measuring Devices:				
Structures and Improvements.....	42,960	0	0	42,960
Equipment.....	121,313	0	0	121,313
Pumping System:				
Structures and Improvements.....	8,699,126	0	0	8,699,126
Equipment.....	1,697,770	0	0	1,697,770
Treatment and Disposal Plant:				
Capacity Rights:				
City of Escondido Sewerage System.....	4,474,873	0	0	4,474,873
Laboratory and Office Furniture and Equipment.....	679,241	2,180	1,557	679,864
General Plant:				
Structures and Improvements.....	229,077	0	0	229,077
Office Furniture and Equipment.....	1,269,555	760,098	118,987	1,910,666
Portable Equipment.....	1,015,053	152,053	11,606	1,155,500
TOTAL MUNICIPAL SEWERAGE SYSTEM.....	408,465,672	22,765,096	166,233	431,064,535
METROPOLITAN SEWERAGE SYSTEM:				
Land and Land Rights:				
Interceptor Mains.....	589,780	0	0	589,780
Pumping System.....	49,605	0	0	49,605
Treatment and Disposal Plants.....	860,322	0	0	860,322
Interceptor Mains.....	37,853,447	0	0	37,853,447
Pumping System:				
Structures and Improvements.....	6,450,034	0	0	6,450,034
Equipment.....	3,941,893	0	0	3,941,893
Treatment and Disposal Plant:				
Structures and Improvements.....	16,360,746	0	0	16,360,746
Equipment.....	6,391,015	0	0	6,391,015
Laboratory and Office Furniture and Equipment.....	6,573,092	4,186,537	67,719	10,691,910
General Transportation Equipment.....	58,303	0	0	58,303
General Plant Portable Equipment.....	2,714,063	681,614	0	3,395,677
Ocean Outfall Intake:				
Structures and Improvements.....	1,780,965	0	0	1,780,965
Equipment.....	323,840	0	0	323,840
Ocean Outfall Line.....	9,301,041	0	0	9,301,041
Sludge Disposal Line.....	391,232	0	0	391,232
Monitoring Vessels.....	384,963	0	0	384,963
TOTAL METROPOLITAN SEWERAGE SYSTEM.....	94,024,341	4,868,151	67,719	98,824,773
CLEAN WATER PROGRAM:				
General Office Furniture and Equipment.....	475,297	2,951,770	398,064	3,029,003
TOTAL CLEAN WATER PROGRAM.....	475,297	2,951,770	398,064	3,029,003
TOTAL SEWERAGE PLANT IN SERVICE.....	\$502,965,310	\$30,585,017	\$632,016	\$532,918,311

Sewer Utility

INSTALLMENT PURCHASE AGREEMENT REQUIREMENTS FOR PRINCIPAL AND INTEREST
JUNE 30, 1996

SCHEDULE A-2

UNAUDITED

INSTALLMENT PURCHASE AGREEMENT

Fiscal Year	Annual Requirements		
	Principal	Interest	Total
1996-97	\$ 4,660,000	\$ 29,102,710	\$ 33,762,710
1997-98	10,960,000	28,939,611	39,899,611
1998-99	11,380,000	28,519,400	39,899,400
1999-2000	11,840,000	28,064,200	39,904,200
2000-01	12,325,000	27,578,760	39,903,760
2001-02	12,845,000	27,057,656	39,902,656
2002-03	13,395,000	26,505,320	39,900,320
2003-04	13,985,000	25,917,817	39,902,817
2004-05	14,615,000	25,288,492	39,903,492
2005-06	15,405,000	24,499,867	39,904,867
2006-07	16,245,000	23,659,568	39,904,568
2007-08	17,135,000	22,769,347	39,904,347
2008-09	17,970,000	21,934,016	39,904,016
2009-10	18,845,000	21,056,045	39,901,045
2010-11	19,780,000	20,121,910	39,901,910
2011-12	20,785,000	19,116,005	39,901,005
2012-13	21,845,000	18,058,980	39,903,980
2013-14	22,960,000	16,941,810	39,901,810
2014-15	24,160,000	15,742,963	39,902,963
2015-16	25,395,000	14,509,038	39,904,038
2016-17	26,690,000	13,212,000	39,902,000
2017-18	28,050,000	11,848,775	39,898,775
2018-19	29,485,000	10,416,050	39,901,050
2019-20	30,995,000	8,909,988	39,904,988
2020-21	32,575,000	7,326,750	39,901,750
2021-22	34,200,000	5,698,000	39,898,000
2022-23	35,910,000	3,988,000	39,898,000
2023-24	21,390,000	2,192,500	23,582,500
2024-25	22,460,000	1,123,000	23,583,000
TOTAL INSTALLMENT PURCHASE AGREEMENT	\$ 588,285,000	\$ 530,098,578	\$ 1,118,383,578

Sewer Utility

OPERATING EXPENSES
FOR THE YEARS ENDED JUNE 30, 1996 AND 1995

SCHEDULE B-1

UNAUDITED

	Year Ended June 30	
	1996	1995
TRANSMISSION:		
Sewer Line Expenses:		
Cleaning and Stoppage Removals, Mains and Laterals.....	\$863,522	\$4,205,084
Accrued Claims.....	1,858,113	1,829,894
Maintenance and Laterals.....	762,437	1,761,177
Maintenance of Mains and Manholes.....	13,583,623	8,607,343
Sewerage Pumping Stations.....	16,196,364	15,383,448
TOTAL TRANSMISSION.....	33,264,059	31,786,946
TREATMENT AND DISPOSAL:		
Cogeneration Facilities.....	1,369,985	1,385,384
Point Loma Plant.....	30,328,211	30,484,524
Escondido System.....	1,133,047	5,065,088
Sewage Testing and Control.....	6,574,769	7,186,512
TOTAL TREATMENT AND DISPOSAL.....	39,406,012	44,121,508
ACCOUNTING SERVICES:		
General Accounting.....	313,502	347,223
Utility Commercial.....	1,846,799	2,124,531
TOTAL ACCOUNTING SERVICES.....	2,160,301	2,471,754
GENERAL AND ADMINISTRATIVE:		
Utilities Administration and General Expense.....	32,285,936	22,760,164
Expense of Other City Departments Applicable to the Sewerage Utility.....	2,955,883	4,280,311
Engineering Expenses.....	1,794,931	2,564,690
Uncollectible Accounts.....	149,733	310,519
TOTAL GENERAL AND ADMINISTRATIVE.....	37,186,483	29,915,684
DEPRECIATION.....	10,966,857	10,058,635
TOTAL OPERATING EXPENSES (Exhibit B).....	\$122,983,712	\$118,354,527

Sewer Utility

ESTIMATED AND ACTUAL CASH RECEIPTS
FOR THE YEAR ENDED JUNE 30, 1996

SCHEDULE F-1

	Estimate	Actual	Actual Over or (Under) Estimate
Sewer Service Charges.....	\$132,937,000	\$132,721,194	(\$215,806)
New Sewer Service Connections.....	110,000	97,042	(12,958)
Sewage Treatment Plant Services.....	44,914,443	31,589,391	(13,325,052)
Sludge Handling Charge.....	357,000	115,403	(241,597)
Interest Earnings.....	12,500,000	15,597,314	3,097,314
Services Rendered Other Funds.....	250,000	421,438	171,438
Services Rendered Others.....	892,900	486,827	(406,073)
Capacity Charge Municipal System.....	15,396,000	12,523,907	(2,872,093)
Sale of Electricity/Gas Engine Generation.....	350,000	225,168	(124,832)
Contributions in Aid.....	45,266,984	49,055,651	3,788,667
Reimbursement Agreements.....	260,554,000	186,621,964	(73,932,036)
Other Revenue.....	375,500	(265,370)	(640,870)
TOTAL RECEIPTS (Exhibit F).....	\$513,903,827	\$429,189,929	(\$84,713,898)

APPROPRIATIONS, EXPENDITURES AND ENCUMBRANCES
FOR THE YEAR ENDED JUNE 30, 1995

SCHEDULE F-2

UNAUDITED

	Appropriation	Expenditures	Encumbrances	Total	Unencumbered Balance
Maintenance and Operation:					
Salaries and Wages.....	\$31,546,512	\$28,143,873	\$0	\$28,143,873	\$3,402,639
Supplies and Expenses.....	118,358,950	81,607,318	18,091,316	99,698,634	18,660,316
Equipment.....	3,537,184	2,532,322	777,318	3,309,640	227,544
Total Maintenance and Operation.....	153,442,646	112,283,513	18,868,634	131,152,147	22,290,499
Outlay:					
Salaries and Wages.....	5,989,557	5,639,464	0	5,639,464	350,093
Construction.....	482,804,092	283,800,552	104,883,594	388,684,146	94,119,946
Equipment.....	(12,868)	35,587	1,471	37,058	(49,926)
Total Outlay.....	488,780,781	289,475,603	104,885,065	394,360,668	94,420,113
Installment Purchase Agreement Interest and Principal..	28,597,000	21,686,686	0	21,686,686	6,910,314
TOTAL (Exhibit F).....	\$670,820,427	\$423,445,802	\$123,753,699	\$547,199,501	\$123,620,926

Sewer Utility

COMPARATIVE STATISTICS - LAST 25 YEARS

UNAUDITED

Fiscal Year	Revenue	Maintenance & Operations Expenses	Depreciation/ Amortization	Bonded Debt Interest	Installment Purchase Agreement Interest	Net Income (Net Loss)	Sewerage Utility Plant
1995 - 1996	\$191,479,486	\$118,989,133	\$10,966,857	\$0	\$19,928,687	\$41,594,809	\$1,570,710,988
1994 - 1995	184,022,332	144,499,560	10,058,635	0	12,467,426	16,996,711	1,255,460,647
1993 - 1994	171,789,868	108,106,286	10,231,072	344,258	8,011,497	45,096,755	1,086,714,363
1992 - 1993	165,387,094	85,908,357	8,691,758	663,368	0	70,123,611	940,408,602
1991 - 1992	156,398,388	84,063,686	8,537,235	759,467	0	63,038,000	789,009,185
1990 - 1991	176,050,678	97,080,094	7,728,094	845,673	0	70,396,817	660,790,628
1989 - 1990	135,010,158	49,310,391	7,595,851	946,601	0	77,157,315	584,655,754
1988 - 1989	105,569,993	52,554,119	7,202,283	1,188,054	0	44,625,537	533,924,815
1987 - 1988	79,905,782	43,078,783	6,552,549	1,093,428	0	29,181,022	495,983,544
1986 - 1987	66,507,806	40,399,201	4,793,238	1,172,475	0	20,142,892	426,717,530
1985 - 1986	61,537,979	40,875,962	4,606,729	1,243,379	0	14,811,909	387,899,143
1984 - 1985	52,213,372	33,411,136	4,358,260	1,317,408	0	13,126,568	361,977,583
1983 - 1984	46,954,543	29,025,029	4,270,337	1,420,917	0	12,238,260	341,933,354
1982 - 1983	36,361,779	27,903,104	4,334,128	1,477,618	0	2,646,929	325,624,027
1981 - 1982	33,920,624	21,445,160	4,154,343	1,576,205	0	6,744,916	305,365,349
1980 - 1981	30,272,181	19,028,259	3,709,590	1,657,258	0	5,877,074	272,093,788
1979 - 1980	25,155,663	14,380,431	3,490,499	1,752,554	0	5,532,179	253,619,444
1978 - 1979	17,561,366	9,995,880	3,286,831	1,846,145	0	2,432,510	237,556,808
1977 - 1978	14,481,158	8,548,148	3,105,951	1,886,886	0	940,173	227,473,005
1976 - 1977	12,812,758	7,435,366	2,818,588	1,943,352	0	615,452	218,329,880
1975 - 1976	13,246,496	7,150,653	2,796,775	2,082,142	0	1,216,926	205,243,617
1974 - 1975	11,430,127	6,151,868	2,532,588	2,134,392	0	611,279	192,958,952
1973 - 1974	10,689,864	4,770,672	2,405,586	2,183,642	0	1,329,964	182,987,436
1972 - 1973	9,884,454	4,427,592	2,196,512	2,228,956	0	1,031,394	171,547,467
1971 - 1972	9,354,922	4,071,662	2,293,680	2,271,022	0	718,558	149,424,423
1970 - 1971	9,487,476	3,762,088	2,346,443	2,327,213	0	1,051,732	139,387,048

Bonded Debt	Installment Purchase Agreement	Retained Earnings	Total System Flow in Million Gallons			Fiscal Year
			Point Loma Plant-Metro	Municipal Plant	Total Flow	
\$0	\$588,285,000	\$553,395,765	65,962.611	1,226.956	67,189.567	1995 - 1996
0	242785000	511800956	66,525.380	1,321.614	67,846.994	1994 - 1995
0	247,145,000	494,804,245	64,153.910	1,310.714	65,464.624	1993 - 1994
12,797,000	0	449,707,490	68,771.580	1,318.696	70,090.276	1992 - 1993
15,089,000	0	511,800,956	64,144.650	1,177.417	65,322.067	1991 - 1992
17,296,000	0	316,545,879	64,819.740	1,365.091	66,184.831	1990 - 1991
19,439,000	0	246,149,062	69,463.382	1,405.081	70,868.463	1989 - 1990
21,461,000	0	168,991,747	66,951.182	1,425.883	68,377.065	1988 - 1989
23,411,000	0	125,792,132	66,545.240	1,316.763	67,862.003	1987 - 1988
25,298,000	0	96,575,236	63,690.392	1,270.092	64,960.484	1986 - 1987
27,133,000	0	76,432,344	54,434.425	1,209.691	55,644.116	1985 - 1986
29,063,000	0	61,620,435	51,818.921	1,217.721	53,036.642	1984 - 1985
31,247,000	0	48,493,867	50,247.377	1,210.064	51,457.441	1983 - 1984
33,492,000	0	36,255,607	49,287.413	1,190.283	50,477.696	1982 - 1983
35,658,000	0	35,170,704	48,486.180	932.985	49,419.165	1981 - 1982
37,683,000	0	28,425,788	47,271.910	992.238	48,264.148	1980 - 1981
39,357,000	0	22,548,714	47,722.390	1,073.023	48,795.413	1979 - 1980
41,135,000	0	17,016,535	45,918.285	943.983	46,862.268	1978 - 1979
42,672,000	0	14,584,025	43,414.000	938.139	44,352.139	1977 - 1978
44,517,000	0	13,643,852	43,043.860	731.222	43,775.082	1976 - 1977
47,350,000	0	13,028,400	40,373.910	674.953	41,048.863	1975 - 1976
48,750,000	0	11,811,474	39,393.540	644.093	40,037.633	1974 - 1975
50,100,000	0	11,200,195	36,176.540	562.366	36,738.906	1973 - 1974
51,400,000	0	9,870,231	36,149.400	470.321	36,619.721	1972 - 1973
52,600,000	0	8,838,837	33,729.820	897.640	34,627.460	1971 - 1972
53,700,000	0	8,120,279	31,966.330	845.552	32,811.882	1970 - 1971

Sewer Utility

GENERAL STATISTICS
FOR THE YEAR ENDED JUNE 30, 1996

TABLE II

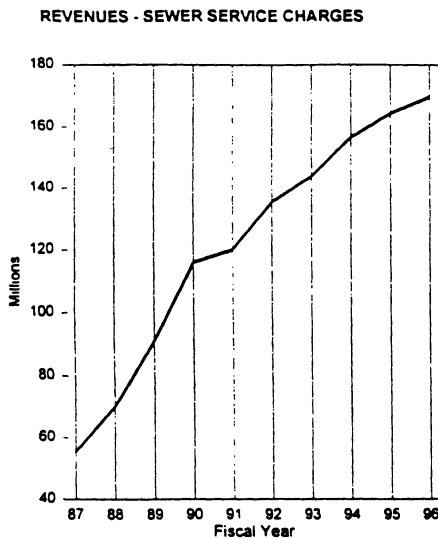
UNAUDITED

Population (Estimated June 30, 1996).....	1,197,676
Sewage Flow RB / San Pasqual Municipal System (Million Gallons).....	1,226.956
Sewage Flow Metropolitan System (Million Gallons).....	65,962.610
Total Sewage Flow Municipal and Metropolitan System (Million Gallons).....	67,189.566
Other Agencies' Sewage Flow (Million Gallons).....	19,114.942
Total City Sewage Flow (Million Gallons).....	48,074.624
Average Daily Municipal and Metropolitan Systems Sewage Flow (Million Gallons).....	183.578
Average Daily City Sewage Flow (Million Gallons).....	131.351
Average Daily City Sewage Flow per Capita (Gallons).....	109.972
Maximum Daily Sewage Flow - Metropolitan System March 13, 1996 (Million Gallons).....	312.950
Minimum Daily Sewage Flow - Metropolitan System December 25, 1995 (Million Gallons).....	154.86
Sewer Service Laterals - June 30, 1995.....	255.027
Municipal Sewer System Mains in Service - June 30, 1995 (Miles).....	2,491.3
Metropolitan Interceptor Sewer Mains in Service - June 30, 1995 (Miles).....	25.41
Sludge Disposal Lines in Service - June 30, 1995 (Miles).....	6.50
Ocean Outfall Line in Service - June 30, 1995 (Miles).....	4.50
Total Sewer Mains and Lines in Service - June 30, 1995 (Miles).....	2,527.7

Sewer Utility

SALES STATISTICS AND PRINCIPAL RATES

TABLE III



CLASS	Year Ending June 30		Growth	
	1996	1995	Amount	Percent
REVENUES - (Thousand Dollars)				
Single Family Domestic	\$56,502	\$56,550	(\$48)	-0.08%
Other Domestic	39,609	38,784	825	2.13%
Commercial	30,957	30,660	297	0.97%
Industrial	7,506	7,173	333	4.64%
Outside City	10	9	1	11.11%
Treat. Plant Serv. for Others	32,921	31,612	1,309	4.14%
TOTAL	\$167,505	\$164,788	\$2,717	1.65%

PRINCIPAL RATES - (As of June 30, 1996)

- For single family dwelling unit serviced by a separate water meter – \$13.48 base fee plus \$2.26 per HCF per month.
- The monthly sewer service charge for all premises other than single family dwellings serviced by separate water meters shall be forty cents (\$0.40) per month, plus a charge per 100 cubic feet of water delivered, computed in accordance with the following table:

User Class	Average Suspended Solids Concentration (Parts per Million)	Rate Per HCF at 70-75% Return to Sewer
A	0-100	1.318
B	101-200	1.478
C	201-300	1.626
D	301-400	1.772
E	401-500	1.932
F	501-600	2.081
G	601-700	2.231
H	701-800	2.231
I	801-900	2.539
J	901-1,000	2.684
K	1,001+	**

* Charge for customers whose return to sewer deviates from 70-75% to be determined based on the following formula:
Rate per HCF = Rate at 70-75% return/class midpoint (72.5% return) X midpoint of appropriate return class.

** Class K/V shall include all dischargers of wastewater whose discharge exceeds 1,000 part per million of suspended solids. The rate per HCF will be individually computed for dischargers in Class K/V on the basis of \$1.613 per HCF of flow, and \$0.209 per 100 parts per million of suspended solids, at 100% return.

- The City Manager has the power to establish reasonable sewer charges, other than those listed above:
 - where sewage is substantially different in volume and type than the average.
 - where water is received from another source than the city's source.
 - where use is such that water supplied is not substantially or entirely discharged into the sewer system.
 - for fire service connection
 - whether not connected to the City's sewer system.
 - where irrigation water is separately measured.

APPENDIX B

**CERTAIN INFORMATION REGARDING
THE CITY OF SAN DIEGO AND AREA**

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APPENDIX B

CERTAIN INFORMATION REGARDING THE CITY OF SAN DIEGO AND AREA

The information and expressions of opinion set forth herein have been obtained from sources believed to be reliable, but such information is not guaranteed as to accuracy or completeness. Statements contained herein which involve estimates, forecasts or matters of opinion, whether or not expressly so described herein, are intended solely as such and are not to be construed as representations of facts. The information and expressions of opinion herein are subject to change without notice, and neither delivery of this Official Statement nor any sale of the 1997 Bonds made thereafter shall under any circumstances create any implication that there has been no change in the affairs of the City or in any other information contained herein since the date of this Official Statement.

INTRODUCTION

With a total population of nearly 1.2 million in 1996 and an area of 403 square miles, the City of San Diego (the "City") is the sixth largest city in the nation and the second largest city in California. The City is the county seat for the County of San Diego (the "County") and is the County's business and financial center.

The City's population grew by 16% between 1987 and 1996 for an average increase of 16,400 annually. A major factor in the City's growth is its quality of life. In addition to having a favorable climate, the City offers a wide range of cultural and recreational services to both residents and visitors. With mild temperatures year round, the City's numerous beaches, parks, tennis courts and golf courses are in constant use.

Another factor in the City's growth is an expanding diversified economy. The City's economic foundation is based on four major areas: high tech manufacturing and research (including electronics, communications equipment, scientific instruments, drugs and biomedical equipment); professional services; tourism; and international trade.

Expansion in the "high tech manufacturing and research" component of the City's economic base has been led by the rapid emergence of telecommunications. Major participants in the City's telecommunications industry include manufacturers of personal communications equipment, radio/TV communications equipment, network communications equipment/systems, satellite communications equipment, and military surveillance/guidance systems. According to the California Employment Development Department ("EDD"), between 1991 and 1995 Countywide employment in the Telecommunications sector increased by 56 percent. The City is the primary location for telecommunications in the County, with the City's Sorrento Valley area emerging as a major center in the development and manufacturing of products using wireless and digital technology.

Another component of the City's "high tech" industry is the Biotechnology sector, which includes companies involved in developing chemical and biological products for use in the treatment and diagnosis of diseases and various medical conditions. According to EDD, between 1991 and 1995, Countywide employment in the biotechnology industry grew by 36 percent. As with telecommunications, the biotechnology industry is concentrated in the City, with the highest concentration in the area around the University of California, San Diego.

The City is also home to a growing software industry. Components within this industry include basic computer programming services, prepackaged software, systems integration services, and development of multimedia products. According to EDD, total Countywide employment in the Software sector totaled 11,000 in 1995, an increase of 45% in the five year period 1991 to 1995.

Contributing to the growth of the City's tourism industry has been the San Diego Convention Center. According to the San Diego Convention and Visitors Bureau ("CONVIS"), during the first ten months of 1996, delegates to conventions at the Convention Center generated total expenditures of approximately \$207 million for the San Diego County economy; during the five year period 1991 to 1995, CONVIS estimates total spending by Convention Center delegates at \$920 million.

The City's emergence as a center for international trade has been made possible in part by the Port of San Diego, which offers world class maritime facilities built around one of the world's great natural harbors. In addition to a location that provides a natural link to Latin America and the Pacific Rim, the Port offers handling services at rates below those of other major west coast ports such as Los Angeles and San Francisco and has established itself as a niche port, attracting general cargo, including automobiles, chemicals and fruit.

ECONOMIC AND DEMOGRAPHIC INFORMATION

Population

Since 1987 the City's population has increased by over 163,000 (or by approximately 16,400 new residents annually). While the rate of growth has slowed in recent years, the City's population still grew by 12,900 people in 1995.

Table 1
POPULATION GROWTH
Calendar Years 1987 through 1996

<u>Calendar Year</u>	<u>City of San Diego</u>	<u>Annual Growth Rate</u>	<u>County of San Diego</u>	<u>Annual Growth Rate</u>	<u>State of California</u>	<u>Annual Growth Rate</u>
1987	1,019,400	2.4%	2,223,600	3.5%	27,388,000	2.4%
1988	1,044,200	2.4	2,300,800	3.5	28,061,000	2.4
1989	1,073,200	2.8	2,388,700	3.8	28,771,000	2.5
1990	1,102,900	3.5	2,480,100	4.6	29,558,000	2.7
1991	1,126,000	1.4	2,539,600	1.7	30,296,000	1.8
1992	1,141,300	1.4	2,583,500	1.7	30,845,000	1.8
1993	1,156,200	1.3	2,614,200	1.2	31,303,000	1.5
1994	1,163,000	0.6	2,638,500	0.9	31,661,000	1.1
1995	1,170,200	0.6	2,658,600	0.8	31,910,000	0.8
1996	1,183,100	1.1	2,690,300	1.2	32,231,000	1.0

Source: State of California Department of Finance.

As indicated in the following table, enrollment in the San Diego Unified School District has continued to grow at a relatively moderate pace during the first half of the 1990's.

Table 2
SAN DIEGO UNIFIED SCHOOL DISTRICT
ENROLLMENT AND ATTENDANCE
School Year 1992-93 through 1996-97

<u>School Year</u>	<u>Enrollment</u>	<u>Average Daily Attendance</u>
1992-93	125,125	121,800
1993-94	127,161	123,509
1994-95	129,539	124,992
1995-96	130,119	127,892
1996-97	133,700	130,284

Source: San Diego Unified School District.

Employment Summary

As seen in Table 3, the City's unemployment rate for calendar year 1996 averaged 5.5%, which was down from a 6.6% rate during calendar year 1995. The City's 1996 unemployment rate was lower than the State's at 7.3%, but above the national rate of 5.4%.

Employment Summary

As seen in Table 3, the City's unemployment rate for calendar year 1996 averaged 5.5%, which was down from a 6.6% rate during calendar year 1995. The City's 1996 unemployment rate was lower than the State's at 7.3%, but above the national rate of 5.4%.

Table 3
ESTIMATED AVERAGE ANNUAL EMPLOYMENT AND
UNEMPLOYMENT OF RESIDENT LABOR FORCE
Calendar Years 1992 through 1996

	<u>1992</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>
Civilian Labor Force City of San Diego					
Employed	509,700	518,200	525,800	525,600	533,300
Unemployed	41,000	44,100	40,500	36,500	30,900
Unemployment Rates⁽¹⁾					
City	7.4%	7.8%	7.2%	6.6%	5.5%
County	7.3	7.7	7.0	6.4	5.4
California	9.1	9.2	8.6	7.8	7.3
United States	7.4	6.8	6.1	5.6	5.4

⁽¹⁾ The unemployment rate is computed from unrounded data and may differ from rates using the rounded figures in this table.
Source: State of California Employment Development Department.

No annual information is regularly compiled on employment by sector for the City alone. As shown in Table 4, during the period 1992 to 1996, total nonagricultural wage and salary employment in the County recorded a net increase of 43,700 new jobs.

Table 4
SAN DIEGO COUNTY
WAGE AND SALARY EMPLOYMENT⁽¹⁾
Calendar Years 1992 through 1996

	<u>1992</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>
Mining	500	400	400	300	300
Construction	43,100	39,500	40,600	43,100	44,000
Manufacturing	124,100	117,500	114,100	114,000	113,500
Nondurable Goods	30,800	32,300	32,300	31,600	31,300
Durable Goods	93,300	85,200	81,800	82,400	82,200
Transportation, Communications, Utilities	34,800	35,700	36,400	37,300	37,700
Trade	221,400	225,500	227,000	229,600	233,500
Wholesale	42,300	39,700	42,000	43,800	44,600
Retail	179,100	185,800	185,100	185,800	188,900
Finance, Insurance, Real Estate Services	61,100	61,100	62,200	55,300	55,300
Government	283,600	283,600	287,300	310,600	320,200
Federal	179,300	179,300	179,100	184,700	186,800
State and Local	45,400	45,400	44,300	45,800	45,400
TOTAL NONAGRICULTURAL	133,900	133,900	134,700	138,900	141,400
	947,800	947,800	947,200	974,900	991,500

⁽¹⁾ Figures may not add to total due to independent rounding.
Source: State of California Employment Development Department.

Manufacturing. During the early 1990's, manufacturing employment in San Diego County recorded sharp declines, due primarily to the relocation of much of its aerospace industry. By 1994, manufacturing employment began to stabilize, with declines of 100 and 600 in 1995 and 1996, respectively, after having dropped by 10,000 during the period 1992 to 1994.

Construction. Construction employment in the County grew by 900 during 1996, after increasing by 2,500 during 1995.

Transportation, Communications and Utilities. The Transportation, Communications and Utilities industry classification added 400 new jobs in the County during 1996, with a gain of 500 in Transportation slightly offset by a net loss of 100 in Communications and Utilities.

Retail and Wholesale Trade. Combined, the Retail and Wholesale Trade sector account for 24% of total nonagricultural wage and salary employment during 1996. Wholesale trade employment in the County increased by 1.8% in 1996, after increasing by 4.3% during 1995. Retail trade employment increased by 3,100 in 1996 after increasing by 700 in 1995.

Finance, Insurance and Real Estate. Countywide employment in the Finance, Insurance and Real Estate sector was unchanged during 1996, after having declined by 3,800 jobs during 1995, with a decrease of 500 in the Finance sector offset by a corresponding equal increase in the Insurance and Real Estate area. Contributing to the drop in Finance was continued restructuring in the banking industry, resulting in fewer branches and a drop in employment.

Services. Employment in the County's Services sector grew by 3.1% in 1996, adding 9,600 jobs, following a gain of 14,500 jobs the previous year. All of the major components within the Services category recorded increases in 1996, with the largest increases occurring in the Other Services category, which includes research and development.

Government. The Government sector, which accounted for 19% of total 1996 nonagricultural wage and salary employment in the County, grew by 1.1% during 1996, with all of the increase occurring among State and Local government agencies; federal employment was down by 400 jobs during the year.

Military Employment And Civilian Defense Spending. According to the San Diego Chamber of Commerce, in 1995 the U.S. Department of Defense contributed about \$9.6 billion to the County's economy through wages paid to uniformed military and civilian personnel and purchases of equipment and services from local businesses. According to the U.S. Department of Commerce's "Consolidated Federal Funds Report," San Diego County had the second highest dollar volume of federal expenditures and obligations by the Department of Defense during federal fiscal year 1995, second only to Los Angeles County. As of June 1, 1995, total active duty military personnel in the County totaled 122,768 and the total civilian employment was 22,500.

According to the San Diego Chamber of Commerce, San Diego County, with a total military and civilian payroll of \$3.6 billion in the federal fiscal year 1995, led all counties in the nation in terms of combined military and civilian payrolls. Total civilian defense contracts awarded to County based businesses totaled \$2.9 billion during the federal fiscal year 1995, up from \$2.3 billion in the previous year.

Under the recommendations of the Base Closure and Realignment Commission ("BRAC") issued in 1995, the City will see an increase in local military spending, while overall federal defense spending continues to decline. Of major significance is the relocation of the U.S. Space and Naval Warfare Systems Command ("SPAWAR") from Virginia to San Diego. According to the San Diego Chamber of Commerce, SPAWAR should have a substantial direct effect on the economies of both the City and the County, with an annual budget of \$4 billion, including \$2.8 billion in private sector contracts, and a workforce of 1,133 military and civilian personnel.

The impact of SPAWAR will extend beyond the immediate effects of its direct administrative activities because of a federal regulation which requires that private contractors with SPAWAR contracts have facilities within the immediate area. It is estimated that these indirect effects could generate an additional 1,000 to 2,000 jobs for the San Diego County economy.

In addition to the SPAWAR recommendation, BRAC '95 also recommended the closure of the Long Beach Naval Shipyard, which had 3,100 civilian employees. The shutdown of the Long Beach facility should result in increased activity for the City's shipyards. According to the San Diego Chamber of Commerce's 1996-97 San Diego County Business Directory, of the seven shipbuilding and repair firms in the County with more than 100 employees, six are located in the City, including the largest, the National Steel and Shipbuilding Company, with more than 3,000 employees.

To expedite plans for the transformation from military to civilian use of the military bases in California selected for closure by BRAC '95, a statewide Base Reuse Task Force was established to promote the rapid conversion of these installations to civilian and government uses that maximize job creation and long term economic growth. One of the BRAC '95 recommendations was the closure of the San Diego Naval Training Center ("NTC"). The Task Force designated the NTC Reuse Planning Committee as the local entity responsible for planning for the reuse of the NTC site. The Committee forwarded its reuse plan recommendations to the City Council in July 1996. The City Council has approved the major elements of the proposed plan, which, upon final adoption, must be approved by the Department of Defense. Under the plan, the site will be used for a variety of purposes, including office/administration space for both commercial and non-profit organizations, recreation, civilian and military housing, training facilities and expansion of the Lindbergh Field International Airport.

Tourism. Tourism and international trade are sectors of the economy that cut across industry lines, and, as such, should be considered separately from the more specific industry classifications addressed in the preceding section.

According to the San Diego Chamber of Commerce, the visitor industry is the County's third largest industry in terms of income generation, behind manufacturing and the military. As shown in Table 6, the total visitor spending in the County totaled \$3.8 billion in 1995, up 4.4% from 1994 and up by almost 16% from 1991. Through October 1996, visitor spending totaled \$3.41 billion, up 6.4% over the same period in 1995.

Table 6
TOTAL VISITOR SPENDING
SAN DIEGO COUNTY
Calendar Years 1992 through 1996
(in billions)

<u>Calendar Year</u>	<u>Amount</u>
1992	\$3.51
1993	3.45
1994	3.64
1995	3.80
1996 ⁽¹⁾	3.41

⁽¹⁾ First ten months only.

Source: San Diego Convention and Visitors Bureau.

As shown in Table 7, contributing to the growth in visitor spending has been a sharp increase in convention spending. Spending by convention delegates at the San Diego Convention Center totaled \$243.7 million in 1995, up from \$184.6 million in 1992. Through October 1996, delegate spending totaled \$206.8 million, down 1.6% from the same period in 1995. The year-to-date decline reflects the unavailability of the Convention Center during most of July and the first part of August in order to prepare for the Republican National Convention. The impact of the pre-convention preparation period is also reflected in delegate attendance figures through October 1996, which were down 13.8% from the same period in 1995.

Table 7
SAN DIEGO CONVENTION CENTER⁽¹⁾
Calendar Years 1992 through 1996

<u>Calendar Year</u>	<u>Estimated Spending</u>	<u>Number of Conventions</u>	<u>Total Delegate Attendance</u>
1992	\$184,575,546	39	317,500
1993	160,112,046	52	236,600
1994	210,435,456	48	232,600
1995	243,669,716	49	330,510
1996 ⁽²⁾	206,890,015	46	253,700

⁽¹⁾ Table includes only the San Diego Convention Center; it does not include other sources of convention activity in the San Diego region.

⁽²⁾ First ten months only.

Source: San Diego Convention and Visitors Bureau.

The City of San Diego is the focal point for tourism in San Diego County. The Convention Center, approximately 75% of the County's hotel and motel rooms and all of the County's major tourist attractions, including the world-renowned San Diego Zoo, the San Diego Wild Animal Park and Sea World, are located in the City. Other attractions located in the City include the Cabrillo National Monument on Point Loma, the historic Gaslamp Quarter in the downtown area, the Old Town State Park, and Balboa Park -- home to the San Diego Zoo and a host of other cultural and recreational activities. According to the San Diego Chamber of Commerce, total attendance at all of these attractions, excluding Sea World, totaled 17.8 million during 1995, up 5.3% from 1994.

Visitor spending is expected to receive a boost beginning in October 1996, with the approval by Congress and signing by the President of the California Cruise Industry

Revitalization Act which permits cruise ships with onboard gambling to make stops at consecutive California ports. A prohibition on such stops adopted by the California legislature in 1993 resulted in a sharp drop in cruise ship calls to San Diego. The lifting of the ban is anticipated to return cruise ship activity to its previous level.

In addition to the many permanent attractions available to visitors, the City has also been host to a number of major events. The City hosted the 1995 America's Cup and has been selected to host Super Bowl XXXII, scheduled for January 1998. In addition, the City was the site for the Republican National Convention held in August 1996.

Associated with the growth in tourism has been the increase in traffic through San Diego's Lindbergh Field International Airport, which recorded a record 6.6 million arrivals during 1995, up 2.2% from 1994, and up by 1 million passengers from 1991's total of 5.7 million.

International Trade

Based on data compiled by the U. S. Department of Commerce for the San Diego Customs District, which includes San Diego and Imperial Counties and a portion of Riverside County, during the period from calendar years 1991 through 1995, the County experienced substantial growth in the volume of international trade. Table 8 below indicates that during 1995, the total dollar value of international trade passing through the San Diego Customs District totaled \$15.0 billion, up 15% from 1994, with exports up 9% and imports up 20%.

Table 8
VALUATION OF INTERNATIONAL TRADE
SAN DIEGO CUSTOMS DISTRICT
Calendar Years 1991 through 1995
(in billions)

<u>Calendar Year</u>	<u>Amount</u>
1991	\$ 8.7
1992	10.1
1993	10.8
1994	13.0
1995	15.0

Source: U.S. Department of Commerce.

With its border location and a diversified manufacturing base, the City believes it is well positioned to take advantage of the North American Free Trade Agreement (NAFTA) and the potential demand of Mexico's economy. This is reflected by the rapid growth of the City's industrial complex located on the Otay Mesa industrial area adjacent to the border with Mexico. Many of the Otay Mesa facilities are twin plants, or "maquiladora," with operations both in the U.S. and Mexico.

Major Employers

The City of San Diego is host to a diverse mix of major employers representing industries ranging from education and health services, to diversified manufacturing, financial services, retail trade and amusement and recreation. The following table was compiled from

information published in the 1996-97 Business Referral Directory of the Greater San Diego Chamber of Commerce. All of the businesses listed below have their main offices in the City, with many having branch offices and/or production facilities in other areas of the County.

Table 9
MAJOR EMPLOYERS ⁽¹⁾
1996

<u>Company</u>	<u>Product/Service</u>
10,000 or More Employees:	
San Diego Unified School District	Education
Sharp Health Care	Health Service
University of California, San Diego	Higher Education
5,000 - 9,999 Employees:	
San Diego Community College District	Higher Education
Scripps Institutions of Medicine and Science	Health Services
U. S. Postal Service	Services
3,000 - 4,999 Employees:	
Cubic Corporation	Electronic Systems
Kaiser Permanente Medical Care Program	Health Care
National Steel & Shipbuilding Co.	Shipbuilding, Repair
Qualcomm	Wireless Communications
Pacific Bell	Utility
San Diego Gas & Electric	Utility
San Diego State University	Higher Education
Science Applications International Corp.	Research and Development
Solar Turbines	Gas Turbine Manufacturing
University of California Medical Center	Health Services
2,000 - 2,999 Employees:	
Bank of America	Banking
Catholic Diocese of San Diego	Churches/Schools
Foodmaker	Food Services
Home Depot	Building Materials
Lucky Stores	Food Services
Manpower Temporary Services	Employment Services
Mercy Hospital & Health Centers	Health Care
Nordstrom	Retail
Palomar Pomerado Health Systems	Health Care
Price Club & Costco Wholesale	Wholesale Warehouses
Sony Engineering & Manufacturing of America	Electronics
Target Stores - San Diego	Retail
Vons Grocery Company	Food Services
Wal-Mart	Retail
Wells Fargo Bank	Banking

⁽¹⁾ Does not include various major public employers, including the City, the County and the federal government other than the U.S. Postal Service.

Source: Greater San Diego Chamber of Commerce.

Effective Buying Income

"Effective Buying Income," also referred to as "disposable" or "after-tax" income, as calculated by *Sales & Marketing Management Magazine*, consists of income less personal tax payments. Income includes wages and salaries, and for data prior to 1995 also included other

labor-related income (such as employer contributions to private pension funds), and certain other income (e.g., proprietor's income; rental income; interest and welfare assistance). Deducted from this total are personal taxes (federal, state and local), certain non-tax payments (e.g., fines, fees and penalties), and personal contributions to a retirement program.

Table 10 shows the per capita Effective Buying Income for the City, the County, the State and the United States for calendar years 1991 through 1995.

Table 10
PER CAPITA EFFECTIVE BUYING INCOME
Calendar Years 1991 through 1995

<u>Calendar Year</u>	<u>City of San Diego</u>	<u>County of San Diego</u>	<u>State of California</u>	<u>United States</u>
1991	\$15,819	\$15,681	\$15,843	\$14,702
1992	16,181	15,947	16,124	15,255
1993	16,667	16,485	16,672	16,064
1994	17,220	17,034	17,275	16,918
1995 ⁽¹⁾	14,770	14,609	14,759	14,965

⁽¹⁾ Data for 1995 reflect changes in the calculation of Effective Buying Income which exclude certain sources of income included in previous years.

Source: Sales & Marketing Management Magazine "Survey of Buying Power."

Building Permits

Table 11 provides a summary of the building permit valuations, and the number of new dwelling units authorized in the City for Fiscal Years 1992 through 1996.

Table 11
BUILDING PERMIT VALUATIONS
AND NUMBER OF DWELLING UNITS
Fiscal Years Ended June 30, 1992 through 1996

	<u>1992</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>
Valuation (in thousands):					
Residential	\$380,666	\$319,210	\$475,878	\$432,957	\$396,681
Nonresidential	<u>271,020</u>	<u>301,123</u>	<u>325,245</u>	<u>382,514</u>	<u>450,301</u>
Total	<u>\$651,686</u>	<u>\$620,333</u>	<u>\$801,123</u>	<u>\$815,471</u>	<u>\$846,982</u>
Number of New Dwelling Units:					
Single Family	1,018	1,118	1,860	1,440	1,468
Multiple Family	<u>1,914</u>	<u>881</u>	<u>992</u>	<u>1,212</u>	<u>774</u>
Total	<u>2,932</u>	<u>1,999</u>	<u>2,852</u>	<u>2,652</u>	<u>2,242</u>

Source: City of San Diego, Development Services Department.

Business Development Program

The City recognizes the need to improve the local business climate and aggressively support economic development and job creation activities. To achieve this, the City has established a comprehensive Business Development Program. A key element of this program is the Business Expansion and Retention Program which represents a new proactive effort on the part of the City to work directly with businesses to improve the retention rate among local firms and to expand the level of investment and job growth.

The primary focus of the City's overall business development effort has been on streamlining the current permitting process and, when feasible, eliminating or reducing existing fees and permits. A major component of this streamlining effort has been the creation of a "one-stop" permitting center to reduce the development permit processing time by as much as one-half. The center eliminates the need for permit applicants to seek approval from several City departments by consolidating the review and permit process into a "one stop" process. In Fiscal Year 1996, the City estimates that its proactive assistance helped to create and retain at least 9,500 jobs. The total valuation of building permits expedited is estimated to be more than \$97 million.

As part of the City's Economic Strategic Plan to attract businesses and keep them competitive, the City has established an Ombudsman Program. The City's Ombuds Program staff work directly and proactively with businesses to provide assistance that results in the retention and expansion of jobs and investment in the City. The primary focus of this program is to retain and attract high tech and biomed/biotech companies. This assistance includes permit expediting, preliminary plan review, and assistance with inspection issues.

As part of the City's efforts to make San Diego more business-friendly, the City Council opened the City's Business Resource Station in 1993, which is an interactive information center designed to provide aspiring entrepreneurs with everything they need to know about starting a small business in the City of San Diego. In 1994, the City Council reduced the Business License Tax for all businesses with 12 or fewer employees from \$125 and \$5 per employee to \$70 per business and \$3 per employee, and in July 1995 reduced it even further, to a flat fee of \$34 per business with no per employee charge. In addition, at the City's request, the County's Air Pollution Control District exempted more than 50 City employers from having to file required traffic abatement plans or from having to pay the filing fee.

Downtown Commercial Development Activity

In downtown San Diego, significant commercial development has occurred over the last several years as a result of the City's redevelopment efforts. For example, Horton Plaza, a major mixed-use retail, entertainment and parking complex, with 900,000 square feet of mixed-use space, two major department stores and approximately 150 specialty shops, added a 12,750 square-foot restaurant as part of a \$16 million renovation completed in March 1995.

In March 1996, the "Hall of Justice" was completed to house the County courthouse. The \$61 million, 79,000 square foot, 13-story facility's main occupants are the District Attorney, the County Marshal and the County Grand Jury. Construction is underway

on a 412,000 square foot maximum security jail at Front and B streets. The San Diego Port District Commission has recently endorsed a plan to develop approximately 2,300 hotel rooms in three different hotel projects, 77,000 square feet of outdoor public areas and up to 225,000 square feet of retail shops and restaurants. In the next several months, the Port District will conduct environmental impact studies and seek plan approval from the State Coastal Commission.

The San Diego Convention Center, with 254,000 square feet of prime exhibit space, was completed in November 1989 at a cost of approximately \$160 million. The Convention Center will nearly double its size by early 2000 by adding 276,000 square feet of exhibit space and 100,000 square feet of meeting rooms. According to a study conducted by CIC Research, Inc. and Price Waterhouse, this \$210 million expansion (including \$29 million for related infrastructure improvements) is projected to increase the Convention Center's annual economic impact (from direct and indirect spending) to the San Diego region (comprised of the City and balance of County) from the current \$641 million to \$1.02 billion. In addition, site acquisition and architect selection was made for a new downtown main library. Any new development is subject to general and local economic conditions as well as the availability of funding sources.

Research Facilities

Among the more important research facilities located in the City are the Scripps Clinic and Research Foundation, the Naval Electronics Laboratory Center, the Palomar Observatory and the Salk Biological Research Institute.

The City was selected as one of the three joint work sites for the Engineering Design Phase of the International Thermonuclear Experimental Reactor ("ITER") project, an internationally funded program to demonstrate the scientific and technological feasibility of using magnetic fusion as a source of electrical power; the other two work sites are in Germany and Japan. The San Diego work site primarily focuses on project integration and the estimated cost of this phase of the program at all work sites is \$1.1 billion. The ITER facility is located in the City's Torrey Pines Science Park. The University of California at San Diego, through its subcontractor Science Applications International Corporation, provides administrative oversight and on-site operational support. The project is expected to serve as a spawning ground for spinoff technologies and businesses, similar to the role played by the Scripps and Salk Institutes, two organizations that provided the catalyst for the City's biomedical industry.

Transportation

San Diego has a well-developed and relatively uncongested highway system. Access in and out of the region is provided by five major freeways running north and south and three freeways running east and west.

Public transportation through the City and metropolitan surrounding communities is provided by the San Diego Metropolitan Transit Development Board ("MTDB"). The San Diego Trolley, Inc. operates a fleet of electric trolleys that provides transportation for commuters and tourists from downtown San Diego to San Ysidro (adjacent to Tijuana), and from

downtown San Diego to Southeast San Diego County and East County. The trolley provides transportation service from downtown San Diego to the waterfront area, including the Convention Center. A \$111.2 million extension that provides service from downtown to the historical Old Town section of the City was completed in June 1996. The Old Town extension features an 1871 vintage terminal located in the Old Town State Park. In addition, construction is in progress on the next extension, which will go from Old Town through the Mission Valley area, ending at San Diego Jack Murphy Stadium. Service is scheduled to begin on the Mission Valley extension in late-1997. The East Line extension to Santee was also completed in June 1996. This 3.6 mile, \$109 million extension connects El Cajon with Santee. A 43-mile Coaster Commuter rail line from Oceanside to downtown San Diego came into service in 1995. This line links communities along the coast from Oceanside to Del Mar with downtown San Diego and is operated by North County Transit District ("NCTD").

Proposition A, voter approved in November 1987, authorized a one-half cent increase to the local sales tax to fund transportation improvements for the San Diego region. The City of San Diego expects to receive \$123 million from this source during Fiscal Years 1994-2000.

State Propositions 108/111/116, voter approved in June 1990, increased the State gas tax and authorized the sale of rail bonds. The revenues generated from these measures are to be used to implement a comprehensive Statewide transportation funding program through the year 2000. Increased revenues to the City of San Diego resulting from Proposition 111's increased gas tax subventions are estimated at \$66.7 million over the ten year period from 1991 through 2000. Revenues from this source supplement the City's street maintenance program, and contribute to capital improvements.

State Proposition 108, the Passenger Rail and Clean Air Act, also authorized the sale of general obligation rail transit bonds by the State of California. These rail bonds are to be used to fund up to 50% of the non-Federal cost of eligible projects throughout the State. Eligible transit projects under this program include trolley and commuter rail corridors, with a possibility of \$100 to \$150 million available for trolley and commuter rail projects within the San Diego region. The designated recipients to develop rail infrastructure in the region are MTDB and NCTD.

A related State ballot measure, Proposition 116, the Clean Air and Transportation Improvement Act, generated revenue from the sale of \$1.99 billion in general obligation rail bonds providing specific allocations to finance rail infrastructure, including intercity, commuter and light rail transit statewide. Similar to State Proposition 108, MTDB and NCTD would be the designated recipients for the San Diego region; \$45 million is estimated to be spent in San Diego County.

MUNICIPAL GOVERNMENT AND FINANCIAL INFORMATION

Governmental Organization

The City of San Diego is a charter city and operates under the Council-Manager form of government. The City Council is comprised of eight members elected by district to serve overlapping four-year terms. The Mayor, who presides over the City Council, is elected at large to serve a four-year term. The City Council, which acts as the City's legislative and policy-making body, selects the City Manager, who is the City's chief administrator and is responsible for implementing the policies and programs adopted by the City Council.

Accounting Practices

The City's accounting policies conform to generally accepted accounting principles applicable to governmental units. The City's Governmental Funds and Expendable Trust and Agency Funds use the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues are recorded when both available and measurable. Certain fines and forfeitures, however, are recorded when received as they are not susceptible to accrual. Expenditures are recognized when the related liability is incurred except for (1) principal of and interest on general long-term debt which are recognized when due; and (2) employee annual leave and claims and judgments for litigation and self-insurance which are recorded in the period due and payable. Proprietary Fund, Pension Trust and Nonexpendable Trust Funds use the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned, and expenses are recorded when incurred.

The City prepares financial statements annually in conformity with generally accepted accounting principles for governmental entities which are audited by an independent certified public accountant. The annual audit report is generally available about 285 days after the June 30 close of each fiscal year. The City's most recent general purpose financial statements for the Fiscal Year ended June 30, 1995 were audited by Calderon, Jaham & Osborn, CPAs.

Budgetary Process

The City's annual budget, which is published in November, is the culmination of the annual budget process which begins in the fall of the preceding year. Public input on service and program priorities is solicited. This input serves as part of the City Council's priority setting for the development of the budget.

Based upon City Council budget priorities, departments submit operating and capital improvement project requests to the City Manager for review by the Financial Management Department. The City Manager evaluates and prioritizes the program requirements, determines funding availability and develops a balanced budget as required by the City Charter. This proposed balanced budget is published and presented to the City Council during April.

City Council review of the proposed budget is conducted during May and June. The first two meetings are dedicated to public comment, while the balance of the meetings are conducted as Council workshops focusing on policy issues.

As required by the City Charter, the City Council adopts the Annual Budget and Appropriation Ordinance no earlier than the date of the first Council meeting in July and no later than the last meeting in July. The adoption of the Appropriation Ordinance requires two noticed public hearings which are usually held on consecutive days. The Annual Tax Rate Ordinance is adopted no later than the last Council meeting in August.

The Financial Management Department works closely with the City Auditor and Comptroller to monitor fund balances. Variations from budget or plans are alleviated in a number of ways, including expenditure reductions or deferrals. Short term issues are resolved with short term solutions. Because the recent recessionary environment lasted longer than usual, the City has begun to implement longer term solutions such as using the City's revenue raising flexibility and making permanent reductions to programs.

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APPENDIX C

DEFINITIONS OF CERTAIN TERMS

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APPENDIX C

DEFINITIONS OF CERTAIN TERMS

The following is a summary of certain definitions set forth in the Indenture and in the Installment Purchase Agreement. These summaries do not purport to be comprehensive and reference should be made to such documents for a full and complete statement of such definitions. All capitalized terms not defined in this summary or this Official Statement shall have the meanings set forth in the Indenture and in the Installment Purchase Agreement.

"Accountant's Report" means a report signed by an Independent Certified Public Accountant.

"Acquisition Costs" means all costs of acquiring, constructing, installing or improving the Project, including but not limited to: (i) all costs which the Authority or the City shall be required to pay to a manufacturer, vendor or contractor or any other person under the terms of any contract or contracts for the acquisition, construction, installation or improvement of the Project; (ii) obligations of the Authority or the City incurred for labor and materials (including obligations payable to the Authority or the City for actual out-of-pocket expenses of the Authority or the City) in connection with the acquisition, construction, installation or improvement of the Project, including reimbursement to the Authority or the City for all advances and payments made in connection with the Project prior to or after delivery of the Bonds; (iii) the costs of performance or other bonds and any and all types of insurance that may be necessary or appropriate to have in effect during the course of acquisition, construction, installation or improvement of the Project; (iv) all costs of engineering and architectural services, including the actual out-of-pocket costs of the Authority or the City for test borings, surveys, estimates, plans and specifications and preliminary investigations therefor, development fees and sales commissions, and for supervising acquisition, construction, installation and improvement, as well as for the performance of all other duties required by or consequent to the proper acquisition, construction, installation or improvement of the Project; and (v) any sums required to reimburse the Authority or the City for advances made by the Authority or the City for any of the above items or for any other costs incurred and for work done by the Authority or the City which are properly chargeable to the acquisition, construction, installation or improvement of the Project.

"Additional Bonds" means all revenue bonds of the Authority which are secured by Installment Payments authorized by and at any time Outstanding pursuant to the Indenture and executed, issued and delivered in accordance with the Indenture.

"AMBAC Indemnity" means AMBAC Indemnity Corporation, a Wisconsin-domiciled stock insurance company.

"Annual Debt Service" means, for any Fiscal Year, the sum of (i) the interest payable on all Outstanding Bonds in such Fiscal Year, assuming that all Outstanding Serial Bonds are retired as scheduled and that all Outstanding Term Bonds are redeemed or paid from sinking

fund payments as scheduled (except to the extent that such interest is to be paid from the proceeds of the sale of any Bonds); (ii) the principal amount of all Outstanding Serial Bonds maturing by their terms in such Fiscal Year; and (iii) the principal amount of all Outstanding Term Bonds required to be redeemed or paid in such Fiscal Year (together with the redemption premiums, if any, thereon).

"Annual Report" means any Annual Report provided by the City pursuant to, and as described in, the Continuing Disclosure Agreement.

"Auditor and Comptroller" means the Auditor and Comptroller of the City.

"Authority" means the Public Facilities Financing Authority of the City of San Diego, a California joint exercise of powers entity.

"Authorized City Representative" means the Mayor, the City Manager or the Treasurer of the City or such other officer or employee of the City or other person who has been designated as such representative by resolution of the City Council of the City.

"Authorized Denominations" means \$5,000 and any integral multiple thereof.

"Authorizing Ordinance" means the ordinance pursuant to which the Installment Purchase Agreement was authorized and any additional Ordinance or official authorizing act of the Council of the City approving execution and delivery of any Supplement to the Installment Purchase Agreement or any Issuing Instrument.

"Balloon Indebtedness" means, with respect to any Series of Obligations, 25% or more of the principal of which matures on the same date or within a 12-month period with sinking fund payments on Term Obligations deemed to be payments of matured principal, that portion of such Series of Obligations which matures on such date or within such date or within such 12-month period; provided, however, that to constitute Balloon Indebtedness the amount of indebtedness maturing on a single date or over a 12-month period must equal or exceed 150% of the amount of such Series of Obligations which matures during any preceding 12-month period. For purposes of this definition, the principal amount maturing on any date shall be reduced by the amount of such indebtedness which is required, by the documents governing such indebtedness, to be amortized by prepayment or redemption prior to its stated maturity date.

"Beneficial Owner" means any person which has or shares the power, directly or indirectly, to make investment decisions concerning ownership of, any 1997 Bonds (including persons holding 1997 Bonds through nominees, depositories or other intermediaries).

"Board" means the Board of Directors of the Authority.

"Bond Counsel" means a firm of attorneys which are nationally recognized as experts in the area of municipal finance.

"Bond Insurer" means Financial Guaranty Insurance Company, doing business in California as FGIC Insurance Company, a New York stock insurance company, or any successor thereto.

"Bonds" means the 1993 Bonds, the 1995 Bonds, the 1997 Bonds and all Additional Bonds.

"Business Day" means a day of the year which is not a Saturday or Sunday, or a day on which banking institutions located in California are required or authorized to remain closed, or on which the New York Stock Exchange is closed. If the date for making any payment or the last date for performance of any act or the exercising of any right, as provided in the Indenture, shall not be a Business Day, such payment may be made or act performed or right exercised on the next succeeding Business Day, with the same force and effect as if done on the nominal date provided in the Indenture, and, unless otherwise specifically provided in the Indenture, no interest shall accrue for the period from and after such nominal date.

"Certificate of Completion" means a Certificate of the City filed with the Trustee, stating that the Components of the Project being financed with the proceeds of the Bonds have been acquired, constructed, installed and improved and that all Acquisition Costs have been paid or provided for.

"Certificate of the City" means an instrument in writing signed by the City Manager, Financial Management Director or City Attorney of the City, or by any other officials of the City duly authorized by the City for that purpose.

"Charter" means the Charter of the City as it now exists or may be amended, and any new or successor Charter.

"City" means the City of San Diego, a municipal corporation duly organized and existing under its Charter and the Constitution of the State.

"Code" means the Internal Revenue Code of 1986, as amended, and the regulations thereunder, and any successor laws or regulations.

"Component Installment Payments" means the Installment Payments specified in the 1997-1 Supplement which are to pay the Purchase Price of the Components.

"Component Obligation Series 1997" means the 1997 Bonds.

"Component Obligation Series 1997A" means the 1997A Bonds.

"Component Obligation Series 1997B" means the 1997B Bonds.

"Components" means components of the Project specified in the 1997-1 Supplement.

"Consultant" means the consultant, consulting firm, engineer, architect, engineering firm, architectural firm, accountant or accounting firm retained by the City to perform acts or

carry out the duties provided for such consultant in the Installment Purchase Agreement. Such consultant, consulting firm, engineer, architect, engineering firm or architectural firm shall be nationally recognized within its profession for work of the character required. Such accountants or accounting firm shall be an Independent Certified Public Accountant licensed to practice in the State.

"Continuing Disclosure Agreement" means that certain Continuing Disclosure Agreement between the City and the Trustee dated March 6, 1997, as originally executed and as it may be amended from time to time in accordance with the terms thereof.

"Contracts" means any contract or lease of the City (including the Installment Purchase Agreement) authorized and executed by the City, the installment or lease payments of which are payable from the Net System Revenues and which are on a parity with the Installment Payments.

"Corporate Trust Office of the Trustee" means the principal corporate trust office of the Trustee in Los Angeles, California or such other or additional offices as may be specified to the Authority by the Trustee in writing.

"Costs of Issuance" means all items of expense directly or indirectly payable by or reimbursable to the City or the Authority relating to the issuance, sale and delivery of the Bonds and the execution and delivery of the Indenture and the Installment Purchase Agreement, filing and recording costs, settlement costs, printing costs, reproduction and binding costs, initial fees and charges of the Trustee (including legal fees), financing discounts, legal fees and charges, insurance fees and charges, financial and other professional consultant fees, fees and charges of rating agencies and/or for credit ratings, fees for transportation and safekeeping of the Bonds and charges and fees in connection with the foregoing.

"Credit Facility" means any line of credit, letter of credit, insurance policy, surety bond or other credit source deposited with the Trustee pursuant to the Indenture.

"Credit Provider" means any municipal bond insurance company, bank or other financial institution or organization which is performing in all material respects its obligations under any Credit Support arrangements for some or all of the Parity Obligations.

"Credit Provider Reimbursement Obligations" means obligations of the City to repay, from Net System Revenues, amounts advanced by a Credit Provider as credit support or liquidity for Parity Obligations.

"Credit Support" means a policy of insurance, a letter of credit, a stand-by purchase agreement, revolving credit agreement or other credit arrangement pursuant to which a Credit Provider provides credit or liquidity support with respect to the payment of interest, principal or the purchase price of any Parity Obligations.

"Debt Service" means for any Fiscal Year, the sum of (i) the interest payable during such Fiscal Year on all outstanding Parity Obligations, assuming that all outstanding Serial Parity Obligations are retired as scheduled and that all outstanding Term Parity Obligations are redeemed or paid from sinking fund payments as scheduled (except to the extent that such

interest is to be paid from the proceeds of sale of any Parity Obligations); (ii) that portion of the principal amount of all outstanding Serial Parity Obligations maturing on the next succeeding principal payment date which falls in such Fiscal Year, (excluding Serial Obligations which at the time of issuance are intended to be paid from the sale of a corresponding amount of Parity Obligations); (iii) that portion of the principal amount of all outstanding Term Parity Obligations required to be redeemed or paid on any redemption date which falls in such Fiscal Year (together with the redemption premiums, if any, thereon); provided that, (i) as to any Balloon Indebtedness, Tender Indebtedness and Variable Rate Indebtedness, interest thereon shall be calculated as provided in the definition of Maximum Annual Debt Service and principal shall be deemed due at the nominal maturity dates thereof; (ii) the amount on deposit in a debt service reserve fund on any date of calculation of Debt Service shall be deducted from the amount of principal due at the final maturity of the Parity Obligations for which such debt service reserve fund was established and in each preceding year until such amount is exhausted; (iii) the amount of any interest payable on any Parity Obligation for which there exists a Qualified Swap Agreement shall be the net amount payable by the City as provided in paragraph (iv) or (viii), as applicable, of the definition of Maximum Annual Debt Service, and (iv) the amount of payments on account of Parity Obligations which are redeemed, retired or repaid on the basis of accreted value due on the scheduled redemption, retirement or repayment date shall be deemed principal payments, and interest that is compounded and paid as part of the accreted value shall be deemed payable on the scheduled redemption, retirement or repayment date but not before.

"Defaulted Obligations" means Obligations in respect of which an Event of Default has occurred and is continuing.

"Depository" means the securities depository acting as Depository pursuant to the Indenture.

"Disclosure Representative" means the City Manager of the City or his or her designee, or such other person as the City shall designate in writing to the Trustee from time to time.

"Dissemination Agent" means Financial and Technical Services Business Center Manager of the City, acting in his or her capacity as Dissemination Agent under the Continuing Disclosure Agreement, or any successor Dissemination Agent designated in writing by the City which has filed with the Trustee a written acceptance of such designation.

"District" means the San Diego Area Wastewater Management District created under Chapter 803 of 1992 Session Laws.

"Federal Securities" means bills, certificates of indebtedness, notes, bonds or other securities which are direct obligations of, or are obligations guaranteed as to principal and interest by, or the principal and interest of which are secured by bills, certificates of indebtedness, notes, bonds or other securities which are direct obligations of or are guaranteed as to principal and interest by, the United States of America, whether issued in book entry form or otherwise; direct obligations of the Export-Import Bank of the United States; consolidated debt obligations of the Federal Home Loan Banks; participation certificates and senior debt obligations of the Federal Home Loan Mortgage Corporation; debentures of the Federal Housing

Administration; mortgage-backed securities (except stripped mortgage securities which are valued greater than par on the portion of unpaid principal); and senior debt obligations of the Federal National Mortgage Association; participation certificates of the General Services Administration; guaranteed mortgage-backed securities and guaranteed participation certificates of the Government National Mortgage Association; guaranteed participation certificates and guaranteed pool certificates of the Small Business Association; local authority bonds of the U.S. Department of Housing & Urban Development; guaranteed Title XI financings of the U.S. Maritime Administration; guaranteed transit bonds of the Washington Metropolitan Area Transit Authority; and stripped obligations of the Resolution Funding Corporation (stripped with the Federal Reserve Bank of New York).

"First Supplemental Indenture" means the First Supplemental Indenture, dated as of May 1, 1994, between the Authority and the Trustee, supplementing and amending the Original Indenture.

"Fiscal Year" means the period beginning on July 1 of each year and ending on the next succeeding June 30, or any other twelve-month period selected and designated as the official Fiscal Year of the City.

"Indenture" means the Original Indenture, as amended by the First Supplemental Indenture, the Second Supplemental Indenture and the Third Supplemental Indenture and as it may from time to time be amended or supplemented by all Supplemental Indentures executed pursuant to the provisions of the Indenture.

"Independent Certified Public Accountant" means any firm of certified public accountants appointed by the City, and each of whom is independent pursuant to the Statement on Auditing Standards No. 1 of the American Institute of Certified Public Accountants.

"Independent Engineer" means any registered engineer or firm of registered engineers of national reputation generally recognized to be well qualified in engineering matters relating to wastewater systems, appointed and paid by the City.

"Information Services" means Financial Information, Inc. "Daily Called Bond Service," 30 Montgomery Street, 10th Floor, Jersey City, New Jersey 17302, Attention: Editor; Kenny Information Services' "Called Bond Service," 65 Broad Street, 16th Floor, New York, New York 10006; Moody's Investors Service's "Municipal and Government," 99 Church Street, 8th Floor, New York, New York 10007, Attention: Municipal News Reports; and Standard and Poor's "Called Bond Record," 25 Broadway, 3rd Floor, New York, New York 10004; or, in accordance with then current guidelines of the Securities and Exchange Commission, to such other addresses and/or such other services providing information with respect to called bonds, or to such services as the Authority may designate in a Certificate of the Authority delivered to the Trustee.

"Installment Payment Date" means any date on which an Installment Payment is due as specified thereto in or determined pursuant to a Supplement.

"Installment Payments" means the Installment Payments scheduled to be paid by the City under and pursuant to the Installment Purchase Agreement or any Supplement thereto.

"Installment Payment Obligations" means Obligations consisting of or which are supported in whole by Installment Payments.

"Installment Purchase Agreement" means the Master Installment Purchase Agreement, dated as of September 1, 1993, entered into between the Authority, as seller, and the City, as purchaser, and as amended and supplemented by the 1993-1 Supplement, the 1995-1 Supplement and the 1997-1 Supplement and as it may from time to time be further amended or supplemented pursuant to the provisions thereof.

"Insured 1993 Bonds" means the 1993 Bonds maturing in the years 1997 to 2013.

"Interest Payment Date" means each February 1 and July 1.

"Interest Portion" means the interest portion of Component Installment Payments specified in the 1997-1 Supplement.

"Issuing Instrument" means any indenture, trust agreement or Installment Purchase Agreement including any Supplement under which Obligations are issued or created.

"Law" means the Charter and all laws of the State supplemental thereto.

"Listed Events" means any of the events listed as significant events in the Continuing Disclosure Agreement.

"Maintenance and Operation Costs of the Metropolitan System" means (i) a Qualified Take or Pay Obligation related to the Metropolitan System; and (ii) reasonable and necessary costs spent or incurred by the City for maintaining and operating the Metropolitan System, calculated in accordance with generally accepted accounting principles, including (among other things) the reasonable expenses of management and repair and other expenses necessary to maintain and preserve the Metropolitan System in good repair and working order, and including administrative costs of the City attributable to the Components which are part of the Metropolitan System, salaries and wages of employees, payments to employees retirement systems (to the extent paid from Metropolitan System Revenues), overhead, taxes (if any), fees from auditors, accountants, attorneys or engineers and insurance premiums, and including all other reasonable and necessary costs of the City or charges required to be paid by it to comply with the terms of the Obligations the proceeds of which are used to acquire Components which are part of the Metropolitan System, including any amounts required to be deposited in the Rebate Fund pursuant to the Tax Certificate relating to the financing of Components which are part of the Metropolitan System, fees and expenses payable to any Credit Provider (other than in repayment of a Credit Provider Reimbursement Obligation), and including expenses incurred or accrued incident to the formation of an entity to which the City may transfer substantially all of the Metropolitan System pursuant to the Installment Purchase Agreement, but excluding in all cases (i) depreciation, replacement and obsolescence charges or reserves therefor; (ii) amortization of intangibles or other bookkeeping entries of a similar nature; (iii) costs of capital

additions, replacements, betterments, extensions or improvements to the Metropolitan System, which under generally accepted accounting principles are chargeable to a capital account or to a reserve for depreciation; (iv) charges for the payment of principal and interest on any general obligation bond heretofore or hereafter issued for Metropolitan System purposes; and (v) charges for the payment of principal and interest on account of any Obligation.

"Maintenance and Operation Costs of the Municipal System" means (i) a Qualified Take or Pay Obligation related to the Municipal System; and (ii) reasonable and necessary costs spent or incurred by the City for maintaining and operating the Municipal System, calculated in accordance with generally accepted accounting principles, including (among other things) the reasonable expenses of management and repair and other expenses necessary to maintain and preserve the Municipal System in good repair and working order, and including administrative costs of the City attributable to the Components which are part of the Municipal System, salaries and wages of employees, payments to employees retirement systems (to the extent paid from Municipal System Revenues), overhead, taxes (if any), fees from auditors, accountants, attorneys or engineers and insurance premiums, and including all other reasonable and necessary costs of the City or charges required to be paid by it to comply with the terms of the Obligations the proceeds of which are used to acquire Components which are part of the Municipal System, including any amounts required to be deposited in the Rebate Fund pursuant to the Tax Certificate relating to the financing of Components which are part of the Municipal System, fees and expenses payable to any Credit Provider (other than in repayment of a Credit Provider Reimbursement Obligation), but excluding in all cases (i) depreciation, replacement and obsolescence charges or reserves therefor; (ii) amortization of intangibles or other bookkeeping entries of a similar nature; (iii) costs of capital additions, replacements, betterments, extensions or improvements to the Municipal System, which under generally accepted accounting principles are chargeable to a capital account or to a reserve for depreciation; (iv) charges for the payment of principal and interest on any general obligation bond heretofore or hereafter issued for Municipal System purposes; and (v) charges for the payment of principal and interest on account of any Obligation.

"Maintenance and Operation Costs of the Wastewater System" means (i) a Qualified Take or Pay Obligation related to the Wastewater System; and (ii) reasonable and necessary costs spent or incurred by the City for maintaining and operating the Wastewater System, calculated in accordance with generally accepted accounting principles, including (among other things) the reasonable expenses of management and repair and other expenses necessary to maintain and preserve the Wastewater System in good repair and working order, and including administrative costs of the City attributable to the Project and the Installment Purchase Agreement, salaries and wages of employees, payments to employees retirement systems (to the extent paid from System Revenues), overhead, taxes (if any), fees from auditors, accountants, attorneys or engineers and insurance premiums, and including all other reasonable and necessary costs of the City or charges required to be paid by it to comply with the terms of the Obligations, including this Installment Purchase Agreement, including any amounts required to be deposited in the Rebate Fund pursuant to the Tax Certificate, relating to the financing of Components which are part of the Wastewater System, fees and expenses payable to any Credit Provider (other than in repayment of a Credit Provider Reimbursement Obligation), and expenses incurred or accrued incident to the formation of an entity to which the City may transfer substantially all of the Metropolitan System pursuant to the Installment Purchase

Agreement, but excluding in all cases (i) depreciation, replacement and obsolescence charges or reserves therefor; (ii) amortization of intangibles or other bookkeeping entries of a similar nature; (iii) costs of capital additions, replacements, betterment, extensions or improvements to the Wastewater System, which under generally accepted accounting principles are chargeable to a capital account or to a reserve for depreciation; (iv) charges for the payment of principal and interest on any general obligation bond heretofore or hereafter issued for Wastewater System purposes; and (v) charges for the payment of principal and interest on account of any debt service on account of any obligation on a parity with or subordinate to the Installment Payments.

"Maximum Annual Debt Service" means at any point in time, with respect to Parity Obligations then Outstanding, the maximum amount of principal and interest becoming due on the Parity Obligations in the then current or any future Fiscal Year, calculated by the City or by an Independent Certified Public Accountant as provided in this definition and provided to the Trustee. For purposes of calculating Maximum Annual Debt Service, the following assumptions shall be used to calculate the principal and interest becoming due in any Fiscal Year:

(i) in determining the principal amount due in each year, payments shall (except to the extent a different subsection of this definition applies for purposes of determining principal maturities or amortization) be assumed to be made in accordance with any amortization schedule established for such debt, including the amount of any Parity Obligations which are or have the characteristics of commercial paper and which are not intended at the time of issuance to be retired from the sale of a corresponding amount of Parity Obligations, and including any scheduled mandatory redemption or prepayment of Parity Obligations on the basis of accreted value due upon such redemption or prepayment, and for such purpose, the redemption payment or prepayment shall be deemed a principal payment; in determining the interest due in each year, interest payable at a fixed rate shall (except to the extent subsection (ii) or (iii) of this definition applies) be assumed to be made at such fixed rate and on the required payment dates;

(ii) if all or any portion or portions of an Outstanding Series of Parity Obligations constitutes Balloon Indebtedness or if all or any portion or portions of a Series of Parity Obligations or such payments then proposed to be issued would constitute Balloon Indebtedness, then, for purposes of determining Maximum Annual Debt Service, each maturity which constitutes Balloon Indebtedness shall be treated as if it were to be amortized in substantially equal annual installments of principal and interest over a term of 25 years commencing in the year the stated maturity of such Balloon Indebtedness occurs, the interest rate used for such computation shall be determined as provided in (iv) or (v) below, as appropriate, and all payments of principal and interest becoming due prior to the year of the stated maturity of the Balloon Indebtedness shall be treated as described in (i) above;

(iii) if any of the Outstanding Series of Parity Obligations constitutes Tender Indebtedness or if Parity Obligations proposed to be issued would constitute Tender Indebtedness, then for purposes of determining Maximum Annual Debt Service, Tender Indebtedness shall be treated as if the principal amount of such Parity Obligations were to be amortized in accordance with the amortization schedule set forth in such Tender

Indebtedness or in the standby purchase or liquidity facility established with respect to such Tender Indebtedness, or if no such amortization schedule is set forth, then such Tender Indebtedness shall be deemed to be amortized in substantially equal annual installments of principal and interest over a term of 25 years commencing in the year in which such Series first subject to tender, the interest rate used for such computation shall be determined as provided in (iv) or (v) below, as appropriate;

(iv) if any Outstanding Parity Obligations constitute Variable Rate Indebtedness (except to the extent paragraph (ii) relating to Balloon Indebtedness or paragraph (iii) relating to Tender Indebtedness applies), the interest rate on such Obligation shall be assumed to be 110% of the daily average interest rate on such Parity Obligations during the 12 months ending with the month preceding the date of calculation, or such shorter period that such Parity Obligations shall have been Outstanding; provided that in the event that such Variable Rate Indebtedness has been issued in connection with a Qualified Swap Agreement, the interest rate for purposes of computing Maximum Annual Debt Service shall be determined by (x) calculating the annualized net amount paid by the City under such Variable Rate Indebtedness and Qualified Swap Agreement (after giving effect to payments made under the Variable Rate Indebtedness and made and received by the City under the Qualified Swap Agreement) during the 12 months ending with the month preceding the date of calculation, or such shorter period that such Qualified Swap Agreement has been in effect, and (y) dividing the amount calculated in clause (x) by the average daily balance of the related Parity Obligations Outstanding during the 12-month period contemplated by clause (x);

(v) if Parity Obligations proposed to be issued will be Variable Rate Indebtedness (except to the extent subsection (ii) relating to Balloon Indebtedness or (iii) relating to Tender Indebtedness applies), then such Parity Obligations shall be assumed to bear interest at 110% of the average of the J.J. Kenny High Grade Index during the prior 12 months ending with the month preceding the date of sale of such additional Parity Obligations, or if that index is no longer published, another similar index selected by the City, or if the City fails to select a replacement index, an interest rate equal to 80% of the yield for outstanding United States Treasury bonds having an equivalent maturity, or if there are no such Treasury bonds having such maturities, 100% of the lowest prevailing prime rate of any of the five largest commercial banks in the United States ranked by assets; provided that in the event that such Variable Rate Indebtedness will be issued in connection with a Qualified Swap Agreement, the interest rate for purposes of computing Maximum Annual Debt Service shall be determined by (a) calculating the net amount to be paid by the City under such Variable Rate Indebtedness and Qualified Swap Agreement after giving effect to payments to be made under the Variable Rate Indebtedness and to be made and received by the City under the Qualified Swap Agreement) for the period during which the Qualified Swap Agreement is to be in effect and for this purpose any variable rate of interest agreed to be paid thereunder shall be deemed to be the rate at which the related Parity Obligation shall be assumed to bear interest, and (b) dividing the amount calculated in clause (a) by the average principal amount of the related Parity Obligation to be Outstanding during the first year after the issuance of such Parity Obligation;

(vi) if moneys or Permitted Investments have been deposited by the City into a separate fund or account or are otherwise held by the City or by a fiduciary to be used to pay principal and/or interest on specified Parity Obligations, then the principal and/or interest to be paid from such moneys, Permitted Investments or from the earnings thereon shall be disregarded and not included in calculating Maximum Annual Debt Service;

(vii) if Parity Obligations are Paired Obligations, the interest thereon shall be the resulting linked rate or effective fixed rate to be paid with respect to such Paired Obligations; and

(viii) in the event that an agreement or commitment which, at the time of calculation is a Qualified Swap Agreement is or is to be in effect with respect to a Parity Obligation which is not Variable Rate Indebtedness, the interest rate of such Parity Obligation for purposes of calculating Maximum Annual Debt Service shall be calculated as follows:

(a) for such a Qualified Swap Agreement which is in effect on the date of calculation, the interest rate shall be calculated in the same manner as is specified in paragraph (iv) for a Qualified Swap Agreement issued in connection with Variable Rate Indebtedness which is Outstanding on the date of calculation; and

(b) for such a Qualified Swap Agreement which is not in effect on the date of calculation, the interest rate shall be calculated in the same manner as is specified in paragraph (v) for a Qualified Swap Agreement to be issued in connection with Variable Rate Indebtedness to be Outstanding after the date of calculation, and for this purpose any variable rate of interest agreed to be paid thereunder shall be assumed to be the rate assumed for Variable Rate Indebtedness described in paragraph (v).

"Maximum Rate" means, on any day, the maximum interest rate allowed by law.

"Metropolitan System" means any and all facilities, properties and improvements designated by the City in its sole discretion as part of the Metropolitan System, and used for the conveyance from the Municipal System and treatment of sewage collected by the City through its Municipal System or by any of the Participating Agencies.

"Metropolitan System Revenues" means all income, rents, rates, fees, charges and other moneys derived from the ownership or operation of the Metropolitan System, including, without limiting the generality of the foregoing, (i) all income, rents, rates, fees, charges (including standby and capacity charges), or other moneys derived by the City from the wastewater services, facilities, and commodities or byproducts sold, furnished or supplied through the facilities of or in the conduct or operation of the business of the Metropolitan System, and including, without limitation, investment earnings on the operating reserves to the extent that the use of such earnings is limited to the Metropolitan System by or pursuant to law, earnings on any Reserve Fund for Obligations the proceeds of which were used to finance improvements

which are part of the Metropolitan System, or to fund or refund any such Obligations, but only to the extent that such earnings may be utilized under the Issuing Instrument for the payment of debt service for such Obligations; (ii) the proceeds derived by the City directly or indirectly from the sale, lease or other disposition of a part of the Metropolitan System; (iii) any amount received from the levy or collection of taxes which are solely available and are earmarked for the support of the operation of the Metropolitan System; and (iv) amounts received under contracts or agreements with governmental or private entities and designated for capital costs for Components which are to be part of the Metropolitan System; and (v) grants received from the United States of America or from the State for Components which are to be part of the Metropolitan System; provided, however, that Metropolitan System Revenues shall not include: (a) in all cases, customers' deposits or any other deposits or advances subject to refund until such deposits or advances have become the property of the City; and (b) the proceeds of borrowings. Notwithstanding the foregoing, there shall be deducted from Metropolitan System Revenues any amounts transferred into a Rate Stabilization Fund as contemplated by the Installment Purchase Agreement, and there shall be added to Metropolitan System Revenues any amounts transferred out of such Rate Stabilization Fund to pay Maintenance and Operation Costs of the Metropolitan System.

"Moody's" means Moody's Investors Service, Inc., a Delaware corporation, and its successors, and if such corporation shall for any reason no longer perform the functions of a securities rating agency, "Moody's" shall be deemed to refer to any other nationally recognized securities rating agency designated by the Authority and the City.

"Municipal System" means any and all facilities, properties and improvements at any time owned, controlled or operated by the City, and designated by the City in its sole discretion as part of the Municipal System, for the collection of sewage from the points of origination thereof and the conveyance thereof to the Metropolitan System.

"Municipal System Revenues" means all income, rents, rates, fees, charges and other moneys derived from the ownership or operation of the Municipal System, including, without limiting the generality of the foregoing, (i) all income, rents, rates, fees, charges (including standby and capacity charges), or other moneys derived by the City from the wastewater services, facilities, and commodities or byproducts sold, furnished or supplied through the facilities of or in the conduct or operation of the business of the Municipal System, and including, without limitation, investment earnings on the operating reserves to the extent that the use of such earnings is limited to the Municipal System by or pursuant to law, earnings on any Reserve Fund for Obligations the proceeds of which were used to finance improvements which are part of the Municipal System, or to fund or refund any such Obligations, but only to the extent that such earnings may be utilized under the Issuing Instrument for debt service for such Obligations; (ii) the proceeds derived by the City directly or indirectly from the sale, lease or other disposition of a part of the Municipal System; (iii) any amount received from the levy or collection of taxes which are solely available and are earmarked for the support of the operation of the Municipal System; (iv) amounts received under contracts or agreements with governmental or private entities and designated for capital costs for Components which are to be part of the Municipal System; and (v) grants received from the United States of America or from the State for Components which are to be part of the Municipal System: provided, however, that Municipal System Revenues shall not include: (i) in all cases, customers' deposits or any other

deposits or advances subject to refund until such deposits or advances have become the property of the City; and (ii) the proceeds of borrowings. Notwithstanding the foregoing, there shall be deducted from Municipal System Revenues any amounts transferred into a Rate Stabilization Fund as contemplated by the Installment Purchase Agreement and there shall be added to Municipal System Revenues any amounts transferred out of such Rate Stabilization Fund to pay Maintenance and Operation Costs of the Municipal System.

"National Repository" means any Nationally Recognized Municipal Securities Information Repository for purposes of the Rule.

"Net Proceeds" means when used with respect to any insurance, self insurance or condemnation award, the proceeds from such award remaining after payment of all expenses (including attorneys' fees) incurred in the collection of such proceeds.

"Net Metropolitan System Revenues" means for any Fiscal Year, the Metropolitan System Revenues for such Fiscal Year less the Maintenance and Operation Costs of the Metropolitan System for such Fiscal Year.

"Net Municipal System Revenues" means for any Fiscal Year, the Municipal System Revenues for such Fiscal Year less the Maintenance and Operation Costs of the Municipal System for such Fiscal Year.

"Net System Revenues" means for any Fiscal Year, the System Revenues for such Fiscal Year less the Maintenance and Operation Costs of the Wastewater System for such Fiscal Year.

"1993 Bonds" means the Public Facilities Financing Authority of the City of San Diego Sewer Revenue Bonds, Series 1993 (Payable Solely from Installment Payments Secured by Wastewater System Net Revenues) authorized by and at any time Outstanding pursuant to the Indenture and executed, issued and delivered in accordance with the Original Indenture.

"1995 Bonds" means the Public Facilities Financing Authority of the City of San Diego Sewer Revenue Bonds, Series 1995 (Payable Solely from Installment Payments Secured by Wastewater System Net Revenues) authorized and at any time Outstanding pursuant to the Indenture and executed, issued and delivered in accordance with the Original Indenture as supplemented by the First Supplemental Indenture and the Second Supplemental Indenture.

"1997 Bonds" means, collectively, the 1997A Bonds and the 1997B Bonds.

"1997A Bonds" means the Public Facilities Financing Authority of the City of San Diego Sewer Revenue Bonds, Series 1997A (Payable Solely from Installment Payments Secured by Wastewater System Net Revenues) authorized and at any time Outstanding pursuant to the Indenture and executed, issued and delivered in accordance with the Indenture.

"1997B Bonds" means the Public Facilities Financing Authority of the City of San Diego Sewer Revenue Bonds, Series 1997B (Payable Solely from Installment Payments Secured by Wastewater System Net Revenues) authorized and at any time Outstanding pursuant to the Indenture and executed, issued and delivered in accordance with the Indenture.

"1993-1 Supplement" means the 1993-1 Supplement dated as of September 1, 1993 by and between the City and the Authority, supplementing and amending the Installment Purchase Agreement.

"1995-1 Supplement" means the 1995-1 Supplement dated as of December 1, 1995 by and between the City and the Authority, supplementing and amending the Installment Purchase Agreement.

"1997-1 Supplement" means the 1997-1 Supplement dated as of February 1, 1997 by and between the City and the Authority, supplementing and amending the Installment Purchase Agreement.

"Obligations" means (i) obligations of the City for money borrowed (such as bonds, notes or other evidences of indebtedness) or as installment purchase payments under any contract (including Installment Payments), or as lease payments under any financing lease (determined to be such in accordance with generally accepted accounting principles), the principal and interest on which are payable from Net System Revenues; (ii) obligations to replenish any debt service reserve funds with respect to such obligations of the City; (iii) obligations secured by or payable from any of such obligations of the City; and (iv) obligations of the City payable from Net System Revenues under (a) any contract providing for payments based on levels of, or changes in, interest rates, currency exchange rates, stock or other indices, (b) any contract to exchange cash flows or a series of payments or (c) any contract to hedge payment, currency, rate spread or similar exposure, including but not limited to interest rate swap agreements and interest rate cap agreements.

"Opinion of Bond Counsel" means a written opinion of counsel of recognized national standing in the field of law relating to municipal bonds, appointed and paid by the Authority and satisfactory to the Trustee.

"Original Indenture" means the Indenture, dated as of September 1, 1993, between the Authority and the Trustee.

"Outstanding" when used as of any particular time with reference to Bonds, means (other than Bonds owned or held by or for the account of the Authority or the City) all Bonds theretofore or thereupon executed by the Authority and authenticated and delivered by the Trustee pursuant to the Indenture, except: (i) Bonds theretofore cancelled by the Trustee or surrendered to the Trustee for cancellation; (ii) Bonds paid or deemed to have been paid within the meaning of the Indenture; (iii) Bonds beneficially owned by the City or the Authority; and (iv) Bonds in lieu of or in substitution for which other Bonds shall have been executed by the Authority and authenticated and delivered pursuant to the Indenture; and the term "Outstanding," when used as of any particular time with respect to Obligations, means all Obligations theretofore or thereupon executed, authenticated and delivered by the City or any trustee or other fiduciary, except (i) Obligations theretofore cancelled or surrendered for cancellation; (ii) Obligations paid or deemed to be paid within the meaning of any defeasance provisions thereof; (iii) Obligations owned by the City or the Authority; (iv) Obligations in lieu of or in substitution for which other Obligations have been executed and delivered; and (v) Obligations assumed by the District or other successor in accordance with the Installment Purchase Agreement.

"Owner" means any person who shall be the registered owner of any Outstanding Bond, as shown on the registration books required to be maintained by the Trustee pursuant to the Indenture, and the term "Owner," when used with respect to Obligations means any person who will be the registered owner of any outstanding Obligation certificate or other evidence of a right to receive Installment Payments directly or as security for payment of the Obligation.

"Paired Obligations" means any Series (or portion thereof) of Parity Obligations designated as Paired Obligations in a Supplement or related Issuing Instrument or other document authorizing the issuance or incurrence thereof, which are simultaneously issued or incurred (i) the principal of which is of equal amount maturing and to be redeemed (or cancelled after acquisition thereof) on the same dates and in the same amounts; and (ii) the interest rates which, taken together, result in an irrevocably fixed interest rate obligation of the City for the terms of such Parity Obligations.

"Parity Installment Obligation" means Obligations consisting of or payable from Installment Payments which are not subordinated in right of payment to other Installment Payments.

"Parity Obligations" means, (i) Parity Installment Obligations, (ii) Obligations the principal and interest of which are payable on a parity with Parity Installment Obligations, (iii) Qualified Take or Pay Obligations and (iv) Qualified Swap Agreements. Notwithstanding the foregoing, any amounts payable with respect to a Qualified Swap Agreement which represent termination payments or unwinding payments will not be deemed to be Parity Obligations unless (i) such Qualified Swap Agreement expressly states that such termination payments or unwinding payments are to be considered Parity Obligations and (ii) each Rating Agency which maintains a rating with respect to any Parity Obligation confirms in writing to the City that the inclusion of such termination payments or unwinding payments as Parity Obligations will not result in a downgrading, withdrawal or suspension of such rating.

"Participating Agencies" means the cities and other agencies providing local sewage collection services within their respective areas and which (i) have entered into contracts with the City pursuant to which the City is providing sewage collection, transportation, treatment or disposal services or (ii) are having such services provided by the District or other successor to the City to which the Metropolitan System has been transferred pursuant to the Installment Purchase Agreement.

"Participating Underwriter" means any of the original underwriters of the 1997 Bonds required to comply with the Rule in connection with offering of the 1997 Bonds.

"Payment Fund" means the fund designated in the Issuing Instrument as the fund into which Installment Payments are to be deposited for the purposes of paying principal or interest on related Obligations.

"Permitted Investments" means any of the following to the extent then permitted by law and the Indenture:

(1) direct obligations of, or obligations the principal of and interest on which are unconditionally guaranteed by, the United States of America, including obligations issued or held in book entry form on the books of the Department of the Treasury of the United States and including a receipt, certificate or any other evidence of an ownership interest in an aforementioned obligation, or in specified portions thereof (which may consist of specified portions of interest thereon);

(2) (i) obligations issued by the Federal Farm Credit Bank, Federal Home Loan Bank Board, Federal Home Loan Mortgage Corporation, Student Loan Marketing Association or the Tennessee Valley Authority, or (ii) obligations, participations or other instruments of or issued by, or fully guaranteed as to interest and principal by, the Federal National Mortgage Association (excluding stripped mortgage backed securities which are valued at greater than par on the unpaid principal), or (iii) guaranteed portions of Small Business Administration notes, or (iv) obligations, participations or other instruments of or issued by a federal agency or a United States of America government-sponsored enterprise; provided, however, that prior to investing in investments described in clause (iv) hereof, the City will have provided to the Trustee evidence that such investment is then rated not lower than A by Moody's and S&P;

(3) obligations of any state, territory or commonwealth of the United States of America or any political subdivision thereof or any agency or department of the foregoing; provided, that at the time of their purchase such obligations are rated not lower than A by Moody's and S&P;

(4) bonds, notes, debentures or other evidences of indebtedness issued or guaranteed by any corporation which are, at the time of purchase, rated by Moody's and S&P in their respective highest short-term rating categories, or, if the term of such indebtedness is longer than three years, rated not lower than A by Moody's and S&P;

(5) taxable commercial paper or tax-exempt commercial paper rated in their respective highest rating categories by Moody's and S&P;

(6) variable rate obligations required to be redeemed or purchased by the obligor or its agent or designee upon demand of the holder thereof secured as to such redemption or purchase requirements by a liquidity agreement with a corporation and as to the payment of interest and principal either upon maturity or redemption (other than upon demand by the holder thereof) thereof by an unconditional credit facility of a corporation; provided, that the variable rate obligations themselves are rated in their respective highest rating categories for its short-term rating, if any, and not lower than A for its long-term rating, if any, by Moody's and S&P, and that the corporations providing the liquidity agreement and credit facility have, at the date of acquisition of the variable rate obligation by the Trustee, an outstanding issue of unsecured, uninsured and unguaranteed debt obligations rated not lower than A by Moody's and S&P;

(7) deposits accounts or certificates of deposit, whether negotiable or non-negotiable, issued by a state or national bank (including the Trustee) or a state or federal savings and loan association, provided that such certificates of deposit shall be either (A)

continuously and fully insured by the Federal Deposit Insurance Corporation or (B) have maturities of not more than 365 days (including certificates of deposit) and are issued by any state or national bank or a state or federal savings and loan association, the short term obligations of which are rated in the highest short term letter and numerical rating category by Moody's and S&P;

(8) bills of exchange or time drafts drawn on and accepted by a commercial bank, otherwise known as bankers acceptances, which bank has short-term obligations outstanding which are rated by Moody's and S&P in their respective highest short-term rating categories, and which bankers acceptances mature not later than 270 days from the date of purchase;

(9) any repurchase agreement with any bank or trust company organized under the laws of any state of the United States or any national banking association (including the Trustee) having a minimum permanent capital of one hundred million dollars (\$100,000,000) and with short-term debt rated by Moody's and S&P in their respective three highest short-term rating categories or any government bond dealer reporting to, trading with, and recognized as a primary dealer by, the Federal Reserve Bank of New York, which agreement is secured by any one or more of the securities and obligations described in clauses (1) or (2) above, which shall have a market value (exclusive of accrued interest and valued at least monthly) at least equal to the principal amount of such investment and shall be lodged with the Trustee or other fiduciary, as custodian for the Trustee, by the bank, trust company, national banking association or bond dealer executing such repurchase agreement, and the entity executing each such repurchase agreement required to be so secured shall furnish the Trustee with an undertaking satisfactory to it that the aggregate market value of all such obligations securing each such repurchase agreement (as valued at least monthly) will be an amount equal to the principal amount of such repurchase agreement and Trustee shall be entitled to rely on each such undertaking;

(10) any cash sweep or similar account arrangement of or available to the Trustee, the investments of which are limited to investments described in clauses (1), (2), (3) and (9) of this definition and any money market fund, the entire investments of which are limited to investments described in clauses (1), (2), (3) and (9) of this definition and which money market fund is rated in their respective highest rating categories by Moody's and S&P;

(11) any guaranteed investment contract approved in writing by AMBAC Indemnity with a financial institution or insurance company which has at the date of execution thereof an outstanding issue of unsecured, uninsured and unguaranteed debt obligations or a claims paying ability rated not lower than Aa/AA by Moody's and S&P;

(12) certificates, notes, warrants, bonds or other evidence of indebtedness of the State of California or of any political subdivision or public agency thereof which are rated in the highest short-term rating category or within one of the three highest long term rating categories of Moody's and S&P (excluding securities that do not have a fixed

par value and/or whose terms do not promise a fixed dollar amount at maturity or call date);

(13) for amounts less than \$10,000, interest-bearing demand or time deposits (including certificates of deposit) in a nationally or state-chartered bank, or state or federal savings and loan association in the State, fully insured by the Federal Deposit Insurance Corporation, including the Trustee or any affiliate thereof;

(14) investments in taxable money market funds or portfolios restricted to obligations maturing in one year or less and which funds or portfolios are rated in either of the two highest rating categories by Moody's and S&P, or have or are portfolios guaranteed as to payment of principal and interest by full faith and credit of the United States of America;

(15) any obligations which are then legal investments for moneys of the Authority under the laws of the State; provided, that if such investments are not required to be collateralized or insured such investments shall be issued by entities the debt securities of which are rated in one of the two highest short-term or long-term rating categories by Moody's and S&P; provided further, that any repurchase agreements must be fully secured by collateral security described in clauses (1) and (2) of this definition, which collateral (a) is held by the Trustee or a third party agent during the term of such repurchase agreement and in which collateral the Trustee has a perfected first security interest, (b) has a market value determined at least every thirty days at least equal to 103% of the amount so invested and (c) may be liquidated within seven days if the market value of such collateral is at any time less than the amount so invested;

(16) investments in the Local Agency Investment Fund created pursuant to Section 16429.1 of the California Government Code;

(17) shares of beneficial interest in diversified management companies investing exclusively in securities and obligations described in clauses (1) through (16) of this definition and which companies are rated in their respective highest rating categories by Moody's and S&P or have an investment advisor registered with the Securities and Exchange Commission with not less than five years' experience investing in such securities and obligations and with assets under management in excess of five hundred million dollars (\$500,000,000);

(18) for amounts held in the Acquisition Fund only, any interest rate swap agreement with a counterparty which has at the date of execution thereof an unsecured, uninsured and nonguaranteed long-term obligation rated not lower than A by Moody's and S&P; provided, that such counterparty may satisfy such rating requirements by providing an insurance policy for its obligations under any such swap agreement from an insurer whose unsecured ratings are in the rating categories required above, or alternatively by providing an unconditional, irrevocable, unsecured, uninsured and nonguaranteed guaranty of any other entity, including an affiliated entity, whose unsecured ratings are in the rating categories required above; and

(19) any other obligations which are approved in writing by Moody's (if Moody's is then rating the Bonds), S&P (if S&P is then rating the Bonds) and AMBAC Indemnity.

"Pre-Refunded Municipals" means any bonds or other obligations of any state of the United States of America or of any other agency, instrumentality or local government unit of any such state which are not callable at the option of the obligor prior to maturity or as to which irrevocable instructions have been given by the obligor to call on the date specified in the notice; and which are rated, based on the escrow, in the highest rating category of Moody's and S&P.

"Principal Portion" means the principal portion of Component Installment Payments specified in the 1997-1 Supplement.

"Prior Indenture" means the Indenture, dated as of September 1, 1993, between the Authority and the Trustee, as supplemented by the First Supplemented Indenture, dated as of May 1, 1994, and the Second Supplemental Indenture, dated as of December 1, 1995, each between the Authority and the Trustee.

"Project" means the construction, replacement and improvements to the Wastewater System described in an exhibit attached to the Installment Purchase Agreement and as modified with respect to Components in conformance with the Installment Purchase Agreement.

"Purchase Price" means the principal amount plus interest thereon owed by the City to the Authority under the terms of and as provided in the Installment Purchase Agreement.

"Qualified Swap Agreement" means a contract or agreement, payable from Net System Revenues on a parity with Parity Obligations, intended to place Obligations on the interest rate, currency, cash flow or other basis desired by the City, including, without limitation, any interest rate swap agreement, currency swap agreement, forward payment conversion agreement or futures contract, any contract providing for payments based on levels of, or changes in, interest rates, currency exchange rates, stock or other indices, any contract to exchange cash flows or a series of payments, or any contract, including, without limitation, an interest rate floor or cap, or an option, put or call, to hedge payment, currency, rate, spread or similar exposure, between the City and the counterparty; provided that not less than 30 days prior to the City's execution of such contract or agreement, each Rating Agency which maintains a rating with respect to any Parity Obligation receives notice in writing of the City's pending execution thereof; provided further that at the time of origination each Rating Agency which maintains a rating with respect to any Parity Obligation confirms in writing to the City that the City's execution and delivery of such contract will not result in a downgrading, withdrawal or suspension of such rating; and provided further, that the following requirements shall also be applicable, to the extent they are more restrictive than the foregoing conditions and so long as the Bond Insurer is insuring the payment of principal of and interest on any 1995 Bonds:

1. The provider of such contract or agreement must be rated at least A-/A3 or better by S&P and Moody's (the "Initial Rating Requirement").

2. After satisfaction of the Initial Rating Requirement, the long term indebtedness of such provider or the claims paying ability of such provider shall not fall below Baa2 or BBB by either S&P or Moody's.

"Qualified Take or Pay Obligation" means the obligation of the City to make use of any facility, property or services, or some portion of the capacity thereof, or to pay therefor from System Revenues, or both, whether or not such facilities, properties or services are ever made available to the City for use, and there is provided to the City a certificate of an Independent Engineer to the effect that the incurrence of such obligation will not adversely affect the ability of the City to comply with the provisions of the Installment Purchase Agreement.

"Rating Agencies" means Moody's and S&P, or whichever of them is rating Parity Obligations.

"Rebate Requirement" shall have the meaning specified in any Tax Certificate.

"Record Date" means the fifteenth day preceding an Interest Payment Date, whether or not such day is a Business Day.

"Repository" means each National Repository and the State Repository.

"Reserve Requirement" means, as of any date of calculation, the least of (i) 10% of the proceeds of the Bonds, (ii) Maximum Annual Debt Service for the current or any future Fiscal Year or (iii) 125% of average Annual Debt Service. For purposes of determining if the amount on deposit in the Reserve Fund equals the Reserve Requirement, any Credit Facility shall be deemed to be a deposit in the face amount or stated amount of such Credit Facility, less any unreimbursed drawings or other amounts not reinstated under such Credit Facility.

"Revenues" means all Installment Payments pursuant to the Installment Purchase Agreement and the interest or profits from the investment of money in any account or fund (other than the Rebate Fund) pursuant to the Indenture.

"Rule" means Rule 15c2-12(b)(5) adopted by the Securities and Exchange Commission under the Securities Exchange Act of 1934, as the same may be amended from time to time.

"S&P" means Standard & Poor's Ratings Services, a division of The McGraw Hill Corp., a New York corporation, and its successors, and if such corporation shall for any reason no longer perform the functions of a securities rating agency, "S&P" shall be deemed to refer to any other nationally recognized securities rating agency designated by the Authority and the City.

"Second Supplemental Indenture" means the Second Supplemental Indenture, dated as of December 1, 1995, between the Authority and the Trustee, supplementing and amending the Original Indenture and the First Supplemental Indenture.

"Serial Bonds" means Bonds for which no sinking fund payments are provided.

"Serial Parity Obligations" means Serial Obligations which are Installment Payments or are payable on a parity with Parity Installment Obligations.

"Serial Obligations" means Obligations for which no sinking fund payments are provided.

"Series" means Obligations issued at the same time or sharing some other common term or characteristic and designated as a separate Series.

"Sewer Revenue Fund" means the fund established pursuant to the Ordinances of the City Council of the City and which fund the City agrees and covenants to maintain so long as any Installment Payments or payments due by the City under any Qualified Swap Agreement remain unpaid, and all moneys in such fund shall be held in trust and applied and used solely as provided in the Installment Purchase Agreement.

"State" means the State of California.

"State Repository" means any public or private repository or entity designated by the State as the state repository for the purpose of the Rule and recognized as such by the Securities and Exchange Commission. As of the date of the Continuing Disclosure Agreement, there is no State Repository.

"Subordinated Obligations" means any Obligations, the payment of principal and interest on which are subordinated in right of payment to Parity Obligations.

"Supplement" means a Supplement, substantially in the form of an exhibit attached to the Master Installment Purchase Agreement, dated as of September 1, 1993, between the Authority and the City, providing for the payment of specific Installment Payments as the Purchase Price for Components of the Project, executed and delivered by the City and the Authority.

"Supplemental Indenture" means any indenture then in full force and effect which has been duly executed and delivered by the Authority and the Trustee amendatory of the Indenture or supplemental thereto; but only if, and to the extent that, such Supplemental Indenture is specifically authorized under the Indenture.

"System Revenues" means all income, rents, rates, fees, charges and other moneys derived from the ownership or operation of the Wastewater System, including, without limiting the generality of the foregoing, (i) all income, rents, rates, fees, charges (including standby capacity charges), or other moneys derived by the City from wastewater services, facilities, and commodities or byproducts sold, furnished or supplied through the facilities of or in the conduct or operation of the business of the Wastewater System, but including, without limitation, investment earnings on the operating reserves to the extent that the use of such earnings is limited to the Wastewater System by or pursuant to law, earnings on any Reserve Fund for Obligations but only to the extent that such earnings may be utilized under the Issuing Instrument for the payment of debt service for such Obligations; (ii) the proceeds derived by the City directly or indirectly from the lease of a part of the Wastewater System; (iii) any amount

received from the levy or collection of taxes which are solely available and are earmarked for the support of the operation of the Wastewater System; (iv) amounts received under contracts or agreements with governmental or private entities and designated for capital costs; and (v) grants received from the United States of America or from the State of California; provided, however, that System Revenues shall not include: (a) in all cases, customers' deposits or any other deposits or advances subject to refund until such deposits or advances have become the property of the City; and (b) the proceeds of borrowings. Notwithstanding the foregoing, there will be deducted from System Revenues any amounts transferred into a Rate Stabilization Fund as contemplated by the Installment Purchase Agreement, and there will be added to System Revenues any amounts transferred out of such Rate Stabilization Fund to pay Maintenance and Operation Costs of the Wastewater System.

"Tax Certificate" means the certificate delivered with respect to the Bonds on which it is intended that interest thereon will be excluded from gross income pursuant to Section 103 of the Code.

"Tax-Exempt Installment Payment Obligations" means Installment Payment Obligations in respect of which it is intended that the interest component thereof will be excluded from gross income pursuant to Section 103 of the Code.

"Tender Indebtedness" means any Parity Obligations or portions of Parity Obligations, a feature of which is an option, on the part of the holders thereof, or an obligation, under the terms of such Parity Obligations, to tender all or a portion of such Parity Obligations to the City, a Paying Agent or other fiduciary or agent for payment or purchase and requiring that such Bonds or portions of Bonds or that such rights to payments or portions of payments be purchased if properly presented.

"Term Bonds" means Bonds which are payable on or before their specified maturity dates from sinking fund payments established for that purpose and calculated to retire such Bonds on or before their specified maturity dates.

"Term Obligations" means Obligations which are payable on or before their specified maturity dates from sinking fund payments established for that purpose and calculated to retire such Obligations on or before their specified maturity dates.

"Term Parity Obligations" means Term Obligations which are Parity Obligations or are payable on a parity with Parity Installment Obligations.

"Third Supplemental Indenture" means the Third Supplemental Indenture, dated as of February 1, 1997, between the Authority and the Trustee, supplementing and amending the Original Indenture, the First Supplemental Indenture and the Second Supplemental Indenture.

"Treasurer" means the Treasurer of the City.

"Trustee" means State Street Bank and Trust Company of California, N.A., a national banking association existing under and by virtue of the laws of the United States, or any other

association or corporation which may at any time be substituted in its place as provided in the Indenture.

"Variable Rate Indebtedness" means any portion of indebtedness evidenced by Parity Obligations the interest rate on which is not established at the time of incurrence of such indebtedness and has not, at some subsequent date, been established at a rate which is not subject to fluctuation or subsequent adjustment, excluding Paired Obligations.

"Wastewater Service" means the wastewater collection and treatment services made available or provided by the Wastewater System.

"Wastewater System" means any and all facilities, properties and improvements at any time owned, controlled or operated by the City as part of the Sewer Revenue Fund (defined in the Installment Purchase Agreement) for the collection, treatment, distribution, administration, disposal or reclamation of waste, including the Municipal System and the Metropolitan System. After any transfer of the Metropolitan System permitted by the Installment Purchase Agreement, the term "Wastewater System" shall mean the Municipal System with respect to the City and the Metropolitan System with respect to the transferee.

"Written Request of the Authority" means an instrument in writing signed by the President, the Vice President, the Secretary or the Assistant Secretary of the Authority, or by any other officer of the Authority duly authorized by the Authority for that purpose.

"Written Request of the City" means an instrument in writing signed by the City Manager or the Financial and Technical Services Business Center Manager of the City, or by any other official of the applicable administrative departments of the City duly authorized by the City for that purpose.

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APPENDIX D

SUMMARY OF PRINCIPAL LEGAL DOCUMENTS

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APPENDIX D

SUMMARY OF PRINCIPAL LEGAL DOCUMENTS

The following are brief summaries of certain provisions of the Indenture, the Installment Purchase Agreement and the Continuing Disclosure Agreement. These summaries do not purport to be full and complete statements of the provisions of such documents and are qualified in their entirety by reference to the complete text of such documents. Prior to delivery of the 1997 Bonds, copies of these documents are available from the City and after delivery of the 1997 Bonds, from the Trustee.

THE INDENTURE

General

The Indenture sets forth the terms of the Bonds, the nature and extent of the security for the Bonds, various rights of the Owners of the Bonds, rights, duties and immunities of the Trustee and the rights and obligations of the Authority. Certain provisions of the Indenture are summarized below. Other provisions are summarized in this Official Statement under the caption "DESCRIPTION OF THE SERIES 1997 BONDS." This summary does not purport to be complete or definitive and is qualified in its entirety by reference to the full terms of the Indenture.

In consideration of the acceptance of the Bonds by the Owners thereof, the Indenture will be deemed to be and will constitute a contract between the Authority and the Trustee for the benefit of the Owners from time to time of all Bonds authorized, executed, issued and delivered under the Indenture and then Outstanding to secure the full and final payment of the interest on and principal of and redemption premiums, if any, on all Bonds which may from time to time be authorized, executed, issued and delivered under the Indenture, subject to the agreements, conditions, covenants and provisions contained in the Indenture and all agreements and covenants set forth in the Indenture to be performed by or on behalf of the Authority will be for the equal and proportionate benefit, protection and security of all Owners of the Bonds without distinction, preference or priority as to security or otherwise of any Bonds over any other Bonds by reason of the number or date thereof or the time of authorization, sale, whatsoever, except as expressly provided in the Indenture or therein.

Establishment of Funds and Accounts. The Authority will establish and maintain the Acquisition Fund to be held by the Treasurer and disbursed by the Auditor and Comptroller in accordance with the Indenture. The Indenture establishes the Payment Fund and the Reserve Fund. Within the Payment Fund, the Trustee will establish and maintain an Interest Account, a Principal Account, a Bond Sinking Account and a Redemption Account. Each of the funds and accounts established in the Indenture will be maintained by the Trustee separate and apart from all other moneys of the Authority held by it, for the benefit of the Authority, the City and the Owners of the Bonds and will be expended solely as provided in the Indenture.

Application of the Acquisition Fund. The Treasurer will hold the moneys in the Acquisition Fund and the Auditor and Comptroller will disburse such moneys to pay Acquisition Costs and to pay Costs of Issuance. Such disbursements will be made from time to time upon receipt of a Written Request of the City on behalf of the Authority which states with respect to each disbursement to be made: (a) (1) the requisition number, (2) the name and address of the person, firm or corporation to whom payment is due, (3) the amount to be disbursed, and (4) that each obligation therein has been properly incurred, and is a proper charge against the Acquisition Fund and has not been the basis of any previous disbursement; (b) specifies in reasonable detail the nature of the obligation; and (c) is accompanied by a bill or statement of account for each obligation.

If, after payment by the Auditor and Comptroller of all Written Requests of the City on behalf of the Authority tendered under the provisions of the Indenture, and delivery to the Treasurer, the Auditor and Comptroller and the Trustee of a Certificate of Completion, there remains any balance of money in the Acquisition Fund, all money so remaining will be transferred to the Trustee and deposited, first to the Reserve Fund to the extent necessary to make the amount on deposit therein equal to the Reserve Requirement, and thereafter to the accounts of the Payment Fund as directed by the Authority.

Pledge of Revenues. Subject only to the provisions of the Indenture permitting the application thereof for the purpose and on the terms and conditions set forth therein, while any Bonds remain Outstanding, all Revenues and amounts on deposit in the funds and accounts established under the Indenture (other than amounts on deposit in the Rebate Fund) are irrevocably pledged to the payment of the interest on and principal of the Bonds.

Pursuant to the Indenture, the Authority transfers, conveys and assigns to the Trustee, for the benefit of the Owners, all of the Authority's rights under the Installment Purchase Agreement (excepting certain indemnification rights thereunder), including the right to receive Installment Payments from the City, the right to receive any proceeds of insurance maintained under the Installment Purchase Agreement or any condemnation award rendered with respect to the Project and the right to exercise any remedies provided in the Installment Purchase Agreement in the event of default by the City under the Installment Purchase Agreement.

The Trustee will be entitled to and will receive all of the Revenues, and any Revenues collected or received by the Authority will be deemed held, collected or received by the Authority as agent of the Trustee and will forthwith be paid by the Authority to the Trustee.

Application of the Payment Fund. Subject to the provisions of the Indenture relating to the Authority's Tax Covenants, all money in the Payment Fund will be set aside by the Trustee in the following accounts within the Payment Fund in the following order of priority:

- (a) Interest Account,
- (b) Principal Account, and
- (c) Redemption Account.

All money in each of such accounts will be held in trust by the Trustee and will be applied, used and withdrawn only for the purposes authorized in the Indenture.

Interest Account. On or before each Interest Payment Date, the Trustee will set aside from the Payment Fund and deposit in the Interest Account that amount of money which, together with any money contained in the Interest Account, is equal to the aggregate amount of interest becoming due and payable on all Outstanding Bonds on such Interest Payment Date. No deposit need be made in the Interest Account if the amount contained in the Interest Account is at least equal to the aggregate amount of interest becoming due and payable on all Outstanding Bonds on such Interest Payment Date.

All money in the Interest Account will be used and withdrawn by the Trustee solely for the purpose of paying the interest on the Bonds as it becomes due and payable (including accrued interest on any Bonds purchased or redeemed prior to maturity).

Principal Account. On or before May 15 of each year the Trustee will set aside from the Payment Fund and deposit in the Principal Account an amount of money equal to the aggregate principal amount of all Outstanding Serial Bonds maturing on such May 15 plus the aggregate amount of all sinking fund payments required to be made with respect to the Term Bonds on such May 15. No deposit need be made in the Principal Account if the amount contained therein is at least equal to the aggregate amount of the principal of all Outstanding Serial Bonds maturing by their terms on such May 15 plus the aggregate amount of all sinking fund payments required to be made on such May 15 for all Outstanding Term Bonds.

The Trustee will establish and maintain within the Principal Account a separate subaccount for the Term Bonds of each series and maturity, designated as the "Sinking Account" (the "Sinking Account"). With respect to each Sinking Account, on each mandatory sinking account payment date established for such Sinking Account, the Trustee will apply the mandatory sinking account payment required on that date to the redemption (or payment at maturity) of Term Bonds of the series and maturity for which such Sinking Account was established, upon the notice and in the manner provided in the Indenture or in the Supplemental Indenture pursuant to which such series of Bonds were issued; provided that, at any time prior to giving such notice of such redemption, at the direction of the City or the Authority, the Trustee may apply moneys in such Sinking Account to the purchase of Term Bonds of such series and maturity at public or private sale, as and when and at such prices (including brokerage and other charges, but excluding accrued interest, which is payable from the Interest Account) as will be determined by the Authority, except that the purchase price (excluding accrued interest) will not exceed the redemption price that would be payable for such Bonds upon redemption by application of such mandatory sinking account payment. If, during the twelve-month period immediately preceding said mandatory sinking account payment date, the Trustee has purchased Term Bonds of such series and maturity with moneys in such Sinking Account, such Bonds so purchased will be applied, to the extent of the full principal amount thereof, to reduce said mandatory sinking account payment.

All money in the Principal Account will be used and withdrawn by the Trustee solely for the purpose of paying the principal of the Bonds as they will become due and payable, except

that any money in any Sinking Account will be used and withdrawn by the Trustee only to purchase or to redeem or to pay Term Bonds for which such Sinking Account was created.

Redemption Account. All money in the Redemption Account will be held in trust by the Trustee and will be applied, used and withdrawn either to redeem Bonds pursuant to the Indenture or for the purposes authorized in the Indenture. Any moneys which, pursuant to the prepayment section of the Installment Purchase Agreement, are to be used to redeem Bonds will be deposited by the Trustee in the Redemption Account. The Trustee will, on the scheduled redemption date, withdraw from the Redemption Account and pay to the Owners entitled thereto an amount equal to the redemption price of the Bonds to be redeemed on such date.

Any delinquent Installment Payments with respect to the Project will be applied first to the Interest Account for the immediate payment of interest payments past due and then to the Principal Account for immediate payment of principal payments past due according to the tenor of any Bond, and then to the Reserve Fund to the extent necessary to make the amount on deposit therein equal to the Reserve Requirement. Any remaining money representing delinquent Installment Payments will be deposited in the Payment Fund to be applied in the manner provided therein.

Reserve Fund. After making the required deposits into the accounts of the Payment Fund, the Trustee will deposit in the Reserve Fund an amount of money which, together with the amount already on deposit therein, will be equal to the Reserve Requirement. No deposit need be made in the Reserve Account so long as there will be on deposit therein a sum equal to at least the Reserve Requirement. The Trustee will promptly notify the City if the amount on deposit in the Reserve Account is less than the Reserve Requirement.

All money in the Reserve Fund shall be used and withdrawn by the Trustee solely for the purpose of paying the interest on, or principal of, or redemption premiums, if any, on the Bonds in the event that no other money of the Authority is lawfully available therefor, or for the retirement of all Bonds then Outstanding. All interest income received by the Trustee on investment of moneys in the Reserve Fund shall be retained in the Reserve Fund so long as amounts on deposit in the Reserve Fund are less than the Reserve Requirement. Subject to the foregoing, earnings and profits on investments in the Reserve Fund after completion of the Project will be transferred to the Payment Fund.

Notwithstanding anything in the Indenture to the contrary, at the option of the City, amounts required to be held in the Reserve Fund may be withdrawn, in whole or in part, upon the deposit of a Credit Facility with the Trustee, in a stated amount equal to the amounts so withdrawn; provided, that prior to the deposit of such Credit Facility, each of the Rating Agencies then rating the Bonds shall be notified of such proposed withdrawal and the deposit of such Credit Facility shall not result in a withdrawal or downgrading of any rating of the Bonds then in effect by each of the Rating Agencies then rating the Bonds. Any such withdrawn moneys shall be transferred, at the election of the City, to the Acquisition Fund, to the Redemption Account in the Payment Fund, to the Principal Account in the Payment Fund or to a special account to be established for the payment of any fees in connection with obtaining such Credit Facility.

Rebate Fund. To the extent required by the Tax Certificate, certain amounts made available by the Authority pursuant to a Written Request of the City will be deposited by the Trustee in the Rebate Fund and thereafter paid to the federal government of the United States of America to the extent required to satisfy the Rebate Requirement (as defined in the Tax Certificate). None of the City, the Authority, the Trustee nor the Owners of the Bonds will have any right in or claim to such money. Any moneys remaining in the Rebate Fund after payment or prepayment of all of the Bonds and payment and satisfaction of any Rebate Requirement, after payment of all fees and expenses of the Trustee, will be remitted to the City.

Investment of Moneys in Funds and Accounts. Moneys in the Acquisition Fund will be accounted for by the Auditor and Comptroller and invested by the Treasurer in any legally permitted investment, including but not limited to the pooled investment fund of the Treasurer. Moneys in the Reserve Fund and the Payment Fund and any accounts therein will, upon the Written Request of the City, be invested by the Trustee in Permitted Investments. In the absence of a Written Request of the City, the Trustee may invest moneys in such funds and accounts in Permitted Investments described in clause (7) of the definition of Permitted Investments. The obligations in which moneys in the said funds and accounts are invested will mature prior to the date on which such moneys are estimated to be required to be paid out under the Indenture; provided that with respect to the Reserve Fund, such obligations will mature no later than ten years from the date of the purchase. Prior to the completion of the acquisition, construction, installation and improvement of the Project, any interest, income or profits from the deposits or investments of all funds and accounts (except the Rebate Fund) will be retained in such fund or account, except that interest, income and profits from the deposits or investments of the Reserve Fund will be deposited in the Interest Account of the Payment Fund so long as amounts on deposit in the Reserve Fund are at least equal to the Reserve Requirement. After the completion of the acquisition, construction, installation and improvement of the Project, any interest, income or profits from the deposits or investments of all funds and accounts (except the Rebate Fund) will be deposited first to the Reserve Fund to the extent amounts on deposit therein are less than the Reserve Requirement, and thereafter to the Interest Account of the Payment Fund. For purposes of determining the amount on deposit in any fund or account held under the Indenture, all investments will be valued at the market value thereof. The Trustee will value the investments in the funds and accounts held under the Indenture semi-annually, on or about May 15 and November 15, and at such times as the Authority deems appropriate.

Issuance of Additional Bonds

The Authority may by Supplemental Indenture issue Additional Bonds payable from the Revenues and secured by the pledge of the Revenues made under the Indenture equal to the pledge securing the Outstanding Bonds previously issued, but only upon compliance by the Authority with the provisions of the Indenture and any additional requirements set forth in such Supplemental Indenture and subject to the following specific conditions, which are conditions precedent to the issuance of any such Additional Bonds.

- (a) The Authority will be in compliance with all agreements and covenants contained in the Indenture and all agreements and covenants contained in the Installment Purchase Agreement.

(b) The Authority will have satisfied the requirements relating to Additional Obligations in the Installment Purchase Agreement.

(c) The issuance of such Additional Bonds will have been authorized by the Authority and will have been provided for by Supplemental Indenture which shall specify the following:

(1) the purpose for which such Additional Bonds are to be issued; provided that such Additional Bonds shall be applied solely for the purpose of (i) financing or refinancing additional improvements to the Project, and/or (ii) refunding any Bonds then Outstanding;

(2) the authorized principal amount and designation of such Additional Bonds;

(3) the dated date and the maturity dates of, and the sinking fund payment dates, if any, the interest payment dates (which will be Interest Payment Dates) for such Additional Bonds;

(4) that such Additional Bonds will be issued only in Authorized Denominations;

(5) the redemption premiums, if any, and the redemption terms, if any, for such Additional Bonds;

(6) the amount, if any, to be deposited from the proceeds of sale of such Additional Bonds in the Interest Account;

(7) the amount, if any, to be deposited from the proceeds of sale of such Additional Bonds in the Acquisition Fund;

(8) the amount to be deposited from the proceeds of sale of such Additional Bonds in the Reserve Fund, which amount will be sufficient to cause the amount on deposit in the Reserve Account to equal the Reserve Requirement upon the issuance of such Additional Bonds;

(9) the forms of such Additional Bonds; and

(10) such other provisions as are necessary or appropriate and not inconsistent with the Indenture.

(d) The Installment Purchase Agreement will have been amended to increase the Installment Payments by the City thereunder by an amount at least sufficient to pay the interest on and principal of such Additional Bonds as the same become due.

Nothing contained in the Indenture will limit the issuance of any revenue bonds of the Authority payable from the Revenues and secured by a pledge of the Revenues if after the

issuance and delivery of such revenue bonds none of the Bonds issued under the Indenture will be Outstanding.

Selected Covenants of the Authority

Punctual Payment and Performance. The Authority will punctually pay the interest on and the principal of and redemption premiums, if any, to become due on every Bond issued under the Indenture in strict conformity with the terms of the Indenture and of the Bonds, and will faithfully observe and perform all the agreements and covenants contained in the Indenture and in the Bonds.

Tax Covenants. The Authority will not use or permit any proceeds of the 1997 Bonds or any funds of the Authority, directly or indirectly, to acquire any securities or obligations, and will not take or permit to be taken any other action or actions, which would cause any 1997 Bonds to be an "arbitrage bond" within the meaning of the Code or "federally guaranteed" within the meaning of Section 149(b) of the Code and any such applicable regulations promulgated from time to time thereunder and under Section 103(c) of the Internal Revenue Code of 1986, as amended. The Authority will observe and not violate the requirements of Section 148 of the Code and any such applicable regulations. The Authority will comply with all requirements of Sections 148 and 149(b) of the Code to the extent applicable to the 1997 Bonds.

The Authority will not use or permit the use of any proceeds of the 1997 Bonds or any funds of the Authority, directly or indirectly, in any manner, and will not take or omit to take any action that would cause any of the 1997 Bonds to be treated as an obligation not described in Section 103(a) of the Code.

Notwithstanding any provisions of the Indenture, if the Authority provides to the Trustee an opinion of Bond Counsel to the effect that any specified action required under the Indenture is no longer required or that some further or different action is required to maintain the exclusion from gross income for federal income tax purposes of interest with respect to the 1997 Bonds, the Trustee, the Authority and the City may conclusively rely on such opinion in complying with the requirements of the Indenture and the covenants under the Indenture will be deemed to be modified to that extent.

Eminent Domain. If the whole of the Project or so much as to render the remainder unusable for the purposes for which it was used or intended to be used by the City will be taken under the power of eminent domain, the term of the Installment Purchase Agreement will cease as of that day that possession will be taken. The Authority will take or cause to be taken such action as is reasonably necessary to obtain compensation at least equal to the value of the Project or portion thereof taken by eminent domain. If less than the whole of the Project is taken under the power of eminent domain and the remainder is usable for the purposes for which it was used by the City at the time of such taking, then the Installment Purchase Agreement will continue in full force and effect as to such remainder, and the parties thereto waive the benefits of any law to the contrary. So long as any of the Bonds shall be Outstanding, the net proceeds of any award made in eminent domain proceedings for taking the Project or any portion thereof will

be transferred to the Payment Fund. Any such award made after all of the Bonds have been fully paid and retired will be paid to the City.

Accounting Records and Reports. The Authority will keep or cause to be kept proper books of record and accounts in which complete and correct entries will be made of all transactions relating to the receipts, disbursements, allocation and application of the Revenues, and such books will be available for inspection by the Trustee, at reasonable hours and under reasonable conditions. Not more than two hundred seventy (270) days after the close of each Fiscal Year, the Authority will furnish or cause to be furnished to the Trustee a complete financial statement covering receipts, disbursements, allocation and application of Revenues for such Authority Fiscal Year, and including a profit and loss statement and balance sheet. The Authority will also keep or cause to be kept such other information as is required under the Tax Certificate.

The City's Budget. The Authority will supply to the Trustee, as soon as practicable after the beginning of each Fiscal Year, a Certificate of the City certifying that the City has made adequate provision in its annual budget for such Fiscal Year for the payment of all installments due under the Installment Purchase Agreement in such Fiscal Year. If the amounts so budgeted are not adequate for the payment of all installments due under the Installment Purchase Agreement in such Fiscal Year, the Authority will take such action as may be necessary and within its power to cause such annual budget to be amended, corrected or augmented so as to include therein the amounts required to be paid by the City in such Fiscal Year for the payment of all installments due under the Installment Purchase Agreement in such Fiscal Year, and will notify the Trustee of the proceedings then taken or proposed to be taken by the Authority.

Installment Purchase Agreement and Other Documents. The Authority will at all times maintain and vigorously enforce all of its rights under the Installment Purchase Agreement, and will promptly collect all installments due for the purchase of the Project as the same become due under the Installment Purchase Agreement, and will promptly and vigorously enforce its rights against any person who does not pay such installments as they become due under the Installment Purchase Agreement. The Authority will not do or permit anything to be done, or omit or refrain from doing anything, in any case where any such act done or permitted to be done, or any such omission of or refraining from action, would or might be a ground for cancellation or termination of the Installment Purchase Agreement by the purchaser thereunder.

Other Liens. The Authority will keep the Project free from judgements, mechanics' and materialmen's liens (except those arising from the acquisition, construction and installation of the Project) and free from all liens, claims, demands and encumbrances of whatsoever prior nature or character to the end that the security for the Bonds provided in the Indenture will at all times be maintained and preserved free from any claim or liability which, in the judgment of the Trustee, might hamper the Authority in conducting its business or interfere with the City's operation of the Project, and the Trustee at its option may (but will not be obligated to) defend against any and all actions or proceedings in which the validity of the Indenture is or might be questioned, or may pay or compromise any claim or demand asserted in any such action or proceeding; provided, however, that in defending such actions or proceedings or in paying or compromising such claims or demands the Trustee will not in any event be deemed to have waived or released the Authority from liability for or on account of any of its agreements and

covenants contained in the Indenture, or from its liability to defend the validity of the Indenture and the pledge of the Revenues made therein and to perform such agreements and covenants. Nothing in the Indenture will preclude the City, or require the Authority to prevent, the operation or transfers of the Project as permitted under the Installment Purchase Agreement.

Acquisition and Construction of the Project and Sale of the Project. The Authority will acquire and construct the Project, or cause the Project to be acquired and constructed, with moneys in the Acquisition Fund and will sell the Project to the City pursuant to the Installment Purchase Agreement.

The Trustee

Appointment and Acceptance of Duties. Pursuant to the Indenture, the Trustee accepts and agrees to the trusts created by the Indenture, to all of which the Authority agrees and the respective Owners of the Bonds, by their purchase and acceptance thereof, agree.

Duties, Immunities and Liabilities of Trustee. The Trustee will, prior to an event of default under the Indenture, and after the curing of all events of default which may have occurred, perform such duties and only such duties as are specifically set forth in the Indenture and no implied duties or obligations will be read into the Indenture against the Trustee. The Trustee will, during the existence of any event of default (which has not been cured), exercise such of the rights and powers vested in it by the Indenture, and use the same degree of care and skill in their exercise as a prudent person would exercise or use under the circumstances in the conduct of his own affairs.

So long as no event of default under the Indenture has occurred and is continuing, the Authority, with the consent of AMBAC Indemnity, may remove the Trustee at any time and will remove the Trustee if at any time requested to do so by AMBAC Indemnity for any breach of the trust set forth in the Indenture, or by an instrument in writing signed by the Owners of not less than a majority in aggregate principal amount of the Bonds then Outstanding or if at any time the Trustee will cease to be a trust company or bank having the powers of a trust company, having a corporate trust office in California, having a combined capital and surplus of \$100,000,000, and subject to supervision or examination by federal or state authority, or will become incapable of acting, or will commence a case under any bankruptcy, insolvency or similar law, or a receiver of the Trustee or of its property will be appointed, or any public officer will take control or charge of the Trustee or its property or affairs for the purpose of rehabilitation, conservation or liquidation, in each case by giving written notice of such removal to the Trustee, and thereupon will appoint a successor Trustee by an instrument in writing, but any successor trustee must be a trust company or bank having the powers of a trust company, having a corporate trust office in California, having a combined capital and surplus of \$100,000,000 and acceptable to AMBAC Indemnity, and subject to supervision or examination by federal or state authority.

The Trustee may resign by giving prior written notice of such resignation to the Authority and AMBAC Indemnity, and by giving notice of such resignation by mail, first class postage prepaid, to the Owners at the addresses listed in the bond register. Upon receiving such

notice of resignation, the Authority will promptly appoint a successor Trustee by an instrument in writing.

Any removal or resignation of the Trustee and appointment of a successor Trustee will become effective upon acceptance of appointment by the successor Trustee. If no successor Trustee will have been appointed and will have accepted appointment within 45 days of giving notice of removal or notice of resignation as aforesaid, the resigning Trustee, at the expense of the Authority, or any Owner (on behalf of himself and all other Owners) may petition any court of competent jurisdiction for the appointment of a successor Trustee.

Amendment of the Indenture

The Indenture and the rights and obligations of the Authority and of the Owners may be amended at any time by a Supplemental Indenture which will become binding when the written consents of AMBAC Indemnity and the Owners of at least 60% in aggregate principal amount of the Bonds then Outstanding, exclusive of Bonds disqualified as provided in the Indenture, are filed with the Trustee. No such amendment will (a) extend the maturity of or reduce the interest rate on or otherwise alter or impair the obligation of the Authority to pay the interest on or principal of or redemption premium, if any, on any Bond at the time and place and at the rate and in the currency provided in the Indenture without the express written consent of the Owner of such Bond, or (b) permit the creation by the Authority of any pledge of the Revenues superior to or on a parity with the pledge created thereby for the benefit of the Bonds, or (c) increase the dollar amount of the Bonds, or (d) modify any rights or obligations of the Trustee without its prior written assent thereto.

The Indenture and the rights and obligations of the Authority and of the Owners may also be amended at any time by a Supplemental Indenture which will become binding upon adoption without the consent of any Owners (but with the consent of AMBAC Indemnity), but only to the extent permitted by law and after receipt of an approving opinion of Bond Counsel, but only for any one or more of the following purposes: (a) to make such provisions for the purpose of curing any ambiguity or of correcting, curing or supplementing any defective provision contained in the Indenture in regard to questions arising thereunder which the Authority may deem desirable or necessary and not inconsistent therewith and which will not adversely affect the interests of the Owners; (b) to make any other change or addition to the Indenture which will not materially adversely affect the interests of the Owners, or to surrender any right or power reserved therein to or conferred therein on the Authority; or (c) to provide for the issuance of any Additional Bonds and to provide the terms of such Additional Bonds, subject to the conditions and upon compliance with the procedure set forth in the Indenture.

Any amendment or supplement to the Indenture (other than amendments or supplements executed and delivered in connection with the issuance of additional Obligations pursuant to the Installment Purchase Agreement) is subject to the prior written consent of the Bond Insurer, which consent shall not be unreasonably withheld.

Events of Default and Remedies of Owners

The following will be events of default under the Indenture:

- (a) failure in the due and punctual payment of the interest on any Bond when and as the same will become due and payable;
- (b) failure in the due and punctual payment of the principal of or redemption premium, if any, on any Bond when and as the same will become due and payable, whether at maturity as therein expressed or by proceedings for redemption;
- (c) failure by the Authority in the performance of any of the other agreements or covenants required on its part contained in the Indenture, and such default has continued for a period of 60 days after the Authority has been given written notice of such default by the Trustee or by a Credit Facility provider or to the Authority and the Trustee by Owners of not less than 25% of the Bonds;
- (d) if any event of default will have occurred and be continuing under the Installment Purchase Agreement; or
- (e) if the Authority files a petition or answer seeking arrangement or reorganization under the federal bankruptcy laws or any other applicable law of the United States of America or any state therein, or if a court of competent jurisdiction approves a petition filed with or without the consent of the Authority seeking arrangement or reorganization under the federal bankruptcy laws or any other applicable law of the United States of America or any state therein, or if under the provisions of any other law for the relief or aid of debtors any court of competent jurisdiction will assume custody or control of the Authority or of the whole or any substantial part of its property.

If an event of default has occurred and is continuing, the Trustee may, with the consent of AMBAC Indemnity, or shall, at the direction of AMBAC Indemnity, or upon the written request of the Owners of not less than 25% in aggregate principal amount of the Bonds then Outstanding, with the consent of AMBAC Indemnity, by written notice to the Authority and AMBAC Indemnity, shall declare the principal of all Bonds then Outstanding and the interest accrued thereon to be due and payable immediately, and upon any such declaration the same will become due and payable.

In addition, the Trustee in its discretion may, and at the written request of the Owners of not less than 25% in aggregate principal amount of Bonds Outstanding or any provider of a then existing Credit Facility, and upon being indemnified to its satisfaction therefor, will proceed to enforce all rights of the Owners and require the Authority to enforce all rights of the Owners of the Bonds under the Indenture, the Bonds or any law by whatever appropriate judicial proceeding or proceedings the Trustee deems most effectual.

Anything in the Indenture to the contrary notwithstanding, subject to the consent of AMBAC Indemnity and to the limitations and restrictions as to the rights of the Owners, upon

the happening and continuance of any event of default under the Indenture, the Owners of not less than 25% in aggregate principal amount of the Bonds then Outstanding will have the right upon providing the Trustee security and indemnity reasonably satisfactory to it, to direct the method and place of all remedial proceedings to be taken by the Trustee under the Indenture. The Trustee may refuse to follow any direction that conflicts with law or the Indenture or that the Trustee determines is prejudicial to rights of other Owners or would subject the Trustee to personal liability. No Owner of any of the Bonds will have any right to institute any proceeding for the enforcement of any trust under the Indenture, or any other remedy thereunder or on said Bonds, unless such Owner previously has given to the Trustee written notice of an event of default and unless the Owners of not less than 25% in aggregate principal amount of the Bonds then Outstanding will have made written request of the Trustee to institute any such proceeding or other remedy, after the right to exercise such powers will have accrued, and will have afforded the Trustee a reasonable opportunity either to proceed to exercise the powers in the Indenture granted, or to institute such action, suit or proceeding in its or their name; nor unless there also will have been offered to the Trustee security and indemnity satisfactory to it against the costs, expenses and liabilities to be incurred therein or thereby, and the Trustee will not have complied with such request within a reasonable time.

Control of Remedies by Credit Providers Upon Default

Anything in the Indenture to the contrary notwithstanding, upon the occurrence and continuance of an event of default under the Indenture, AMBAC Indemnity will be entitled to control and direct the enforcement of all rights and remedies granted to (1) the Owners of the Insured 1993 Bonds or (2) the Trustee for the benefit of such Owners under the Indenture, including, without limitation: (i) the right to accelerate the principal of the Bonds as described in the Indenture and (ii) the right to annul any declaration of acceleration. AMBAC Indemnity will also be entitled to approve all waivers of events of default.

For all purposes of the Indenture governing events of default and the exercise of remedies thereupon, except the giving of notice of default to Owners of the 1995 Bonds, the Bond Insurer will be deemed to be the sole holder of the 1995 Bonds it has insured and any acceleration of the 1995 Bonds or any annulment thereof shall be subject to the prior written consent of the Bond Insurer (in each case so long as it has not failed to comply with its payment obligations under its bond insurance policy securing the 1995 Bonds). Identical provisions are applicable to the 1997 Bonds. See "Third Supplemental Indenture" below.

Defeasance

If the Authority pays or causes to be paid or there is otherwise paid to the Owners of all Outstanding Bonds the interest thereon and the principal thereof and the redemption premiums, if any, thereon at the times and in the manner stipulated therein, then the Owners of such Bonds will cease to be entitled to the pledge of the Revenues as provided in the Indenture, and all agreements, covenants and other obligations of the Authority to the Owners of such Bonds thereunder will thereupon cease, terminate and become void and be discharged and satisfied.

Subject to the provisions of the above paragraph, when any of the Bonds shall have been paid and the Authority has kept, performed and observed all the covenants and promises in such

Bonds and in the Indenture required to be kept, performed and observed by the Authority or on its part on or prior to that time, then the Indenture will be considered to have been discharged in respect of such Bonds and such Bonds will cease to be entitled to the lien of the Indenture and such lien and all covenants, agreements and other obligations of the Authority under the Indenture will cease, terminate become void and be completely discharged as to such Bonds.

Any Outstanding Bonds will prior to the maturity date or redemption date thereof be deemed to have been paid if (1) in case any of such Bonds are to be redeemed on any date prior to their maturity date, the Authority shall have given to the Trustee in form satisfactory to it irrevocable instructions to mail, on a date in accordance with the provisions of the Indenture notice of redemption of such Bonds on said redemption date, said notice to be given in accordance with the Indenture, (2) there shall have been deposited with the Trustee either (A) money in an amount which shall be sufficient or (B) Federal Securities of which are not subject to redemption prior to maturity except by the holder thereof (including any such Permitted Investments issued or held in book-entry form on the books of the Department of Treasury of the United States of America) and/or Pre-Refunded Municipals, the interest on and principal of which when due, and without any reinvestment thereof, will provide money which, together with the money, if any, deposited with the Trustee at the same time, shall, as verified by an independent certified public accountant, be sufficient, to pay when due the interest to become due on such Bonds on and prior to the maturity date or redemption date thereof, as the case may be, and the principal of and redemption premiums, if any, on such Bonds, and (3) in the event such Bonds are not by their terms subject to redemption within the next succeeding 60 days, the Authority will have given the Trustee in form satisfactory to it irrevocable instructions to mail as soon as practicable, a notice to the Owners of such Bonds and to the Securities Depositories and the Information Services that the deposit required by clause (2) above has been made with the Trustee and that such Bonds are deemed to have been paid in accordance with the Indenture and stating the maturity date or redemption date upon which money is to be available for the payment of the principal of and redemption premiums, if any, on such Bonds.

Third Supplemental Indenture

Creation of 1997A Account of Acquisition Fund; Use of Moneys in 1997A Account.

There is created in the Acquisition Fund an account designated as the "1997A Account." The Treasurer will hold the moneys in the 1997A Account of the Acquisition Fund and the Auditor and Comptroller shall disburse such moneys therefrom to pay Acquisition Costs and to pay Costs of Issuance with respect to the 1997A Bonds.

If, after payment by the Auditor and Comptroller of all Written Requests of the City on behalf of the Authority theretofore tendered to the Auditor and Comptroller under the provisions of the Third Supplemental Indenture and delivery to the Treasurer, the Auditor and Comptroller and the Trustee of a Certificate of Completion with respect to the portion of the Project to be financed with amounts on deposit in the 1997A Account, there remains any balance of money in the 1997A Account, all money so remaining shall be transferred to the Trustee and deposited, first to the Reserve Fund to the extent necessary to make the amount on deposit therein equal to the Reserve Requirement, and thereafter to the accounts of the Payment Fund as directed by the Authority.

Creation of 1997B Account of Acquisition Fund; Use of Moneys in 1997B Account.

There is created in the Acquisition Fund an account designated as the "1997B Account." The Treasurer will hold the moneys in the 1997B Account of the Acquisition Fund and the Auditor and Comptroller shall disburse such moneys therefrom to pay Acquisition Costs and to pay Costs of Issuance with respect to the 1997B Bonds.

If, after payment by the Auditor and Comptroller of all Written Requests of the City on behalf of the Authority theretofore tendered to the Auditor and Comptroller under the provisions of the Third Supplemental Indenture and delivery to the Treasurer, the Auditor and Comptroller and the Trustee of a Certificate of Completion with respect to the portion of the Project to be financed with amounts on deposit in the 1997B Account, there remains any balance of money in the 1997B Account, all money so remaining shall be transferred to the Trustee and deposited, first to the Reserve Fund to the extent necessary to make the amount on deposit therein equal to the Reserve Requirement, and thereafter to the accounts of the Payment Fund as directed by the Authority.

Pledge of Revenues. Pursuant to the Indenture, the 1997 Bonds are special, limited obligations of the Authority payable solely from and secured by Revenues (consisting of Installment Payments made pursuant to the Installment Purchase Agreement) and amounts on deposit in the funds and accounts established under the Indenture (other than amounts on deposit in the Rebate Fund). All such moneys are irrevocably pledged to the payment of principal of, interest on and redemption premium, if any, on the 1997 Bonds. The pledge made under the Indenture constitutes a first lien and pledge of Revenues, and within such lien priority, 1997 Bonds are of equal rank, without preference, priority or distinction, with all other Bonds Outstanding.

Tax Covenants. The Authority covenants to comply with the provisions and procedures of the Tax Certificate relating to the 1997 Bonds, including depositing of all amounts required to be deposited in the Rebate Fund from the sources specified in the Indenture.

The Authority will not use or permit any proceeds of the 1997 Bonds or any funds of the Authority, directly or indirectly, to acquire any securities or obligations, and shall not take or permit to be taken any other action or actions, which would cause any 1997 Bonds to be an "arbitrage bond" within the meaning of the Code or "federally guaranteed" within the meaning of Section 149(b) of the Code and any such applicable regulations promulgated from time to time thereunder and under Section 103(c) of the Code. The Authority shall observe and not violate the requirements of Section 148 of the Code and any such applicable regulations. The Authority shall comply with all requirements of Sections 148 and 149(b) of the Code to the extent applicable to the 1997 Bonds.

The Authority will not use or permit the use of any proceeds of the 1997 Bonds or any funds of the Authority, directly or indirectly, in any manner, and shall not take or omit to take any action that would cause any of the 1997 Bonds to be treated as an obligation not described in Section 103(a) of the Code.

Notwithstanding any provisions of the Third Supplemental Indenture, if the Authority shall provide to the Trustee an opinion of Bond Counsel to the effect that any specified action

required under the tax covenants of the Third Supplemental Indenture is no longer required or that some further or different action is required to maintain the exclusion from gross income for federal income tax purposes of interest with respect to the 1997 Bonds, the Trustee, the Authority and the City may conclusively rely on such opinion in complying with the requirements of the tax covenants of the Third Supplemental Indenture and, notwithstanding the Prior Indenture, the covenants under the Third Supplemental Indenture will be deemed to be modified to that extent.

Continuing Disclosure. The Trustee covenants and agrees that it will comply and carry out all of the provisions of the Continuing Disclosure Agreement. Notwithstanding any other provision of the Indenture, failure of the City or the Trustee to comply with the Continuing Disclosure Agreement shall not be considered an event of default thereunder; however, the Trustee may (and, at the request of any Participating Underwriter, the Bond Insurer or the Owners of at least 25% in aggregate principal amount of Outstanding 1997 Bonds, shall) or the Bond Insurer or any Owner or Beneficial Owner may take such actions as may be necessary and appropriate, including seeking specific performance by court order, to cause the City to comply with its obligations under the 1997-1 Supplement or to cause the Trustee to comply with its obligations under the Third Supplemental Indenture. For additional information, see "The Continuing Disclosure Agreement" below.

Control of Remedies. For all purposes of the Indenture governing events of default and the exercise of remedies thereupon, except the giving of notice of default to Owners of the 1997 Bonds, the Bond Insurer will be deemed to be the sole holder of the 1997 Bonds it has insured and any acceleration of such 1997 Bonds or any annulment thereof shall be subject to the prior written consent of the Bond Insurer (in each case so long as it has not failed to comply with its payment obligations under its bond insurance policy securing such 1997 Bonds).

THE INSTALLMENT PURCHASE AGREEMENT

General

The Installment Purchase Agreement provides the terms and conditions of the purchase of the Project by the City. Certain provisions of the Installment Purchase Agreement are summarized below. These summaries do not purport to be complete or definitive and are qualified in their entireties by reference to the full terms of the Installment Purchase Agreement.

Acquisition and Construction of the Project. The Authority has agreed to cause the Project to be constructed, acquired and installed by the City, as agent of the Authority. The City will enter into contracts and provide for, as agent of the Authority, the complete construction, acquisition and installment of the Project. The City has agreed that it will cause the construction, acquisition and installation of the Project to be diligently performed. Except to the extent of proceeds of the Obligations which are deposited in the Acquisition Fund, the Authority will be under no liability of any kind or character whatsoever for the payment of any cost of any Components. In the event the proceeds of the Obligations deposited in the Acquisition Fund are insufficient to complete the construction, acquisition and installation of Components, the City will cause to be deposited in the Acquisition Fund (or otherwise

appropriate and encumber) from and to the extent of available amounts on deposit in the Sewer Revenue Fund (or other lawfully available moneys) an amount equal to that necessary to complete the construction, acquisition and installation of such Components.

The Authority will not undertake to cause any component of the Project to be constructed, acquired or installed unless and until the City and the Authority have entered into a Supplement specifying the components of the Project to be installed, the date of completion, the Purchase Price to be paid by the City under the Installment Purchase Agreement for that Component of the Project, and the Installment Payments or the method of calculating Installment Payments.

Changes to the Project. The City may modify or amend the description of the Project, to eliminate any part thereof and/or to substitute another Project or Projects, all without obtaining any consent, by filing such modification or amendment with the Authority and the Trustee; provided that no such amendment will substitute a Project or Projects which are not to be owned by the Sewer Revenue Fund or will in any way impair the obligations of the City contained in any Supplement executed prior to such amendment. The City may substitute other improvements for those listed as Components in any Supplement, but only if the City first files with the Authority and the Trustee a certificate of an Authorized City Representative: (a) identifying the Components to be substituted and the Components they replace; (b) stating that the substituted Components will be owned by the Sewer Revenue Fund; and (c) stating that with respect to Components financed with Tax-Exempt Installment Obligations, the estimated costs of construction, acquisition and installation of the substituted improvements are not less than such costs for the improvements previously planned.

Installment Payments

Purchase Price. The City will pay the Purchase Price for any Components being purchased as provided in a Supplement. The Purchase Price to be paid by the City under any Supplement to the Installment Purchase Agreement, solely from Net System Revenues and from no other sources, is the sum of the principal amount of the City's obligations under any Supplement plus the interest to accrue on the unpaid balance of such principal amount from the effective date and over the term of the Supplement, subject to prepayment provisions as provided therein.

The principal amount of the Installment Payments and interest thereon to be made by the City under a Supplement will be paid as specified in such Supplement. Interest shall be payable in an amount not exceeding the Maximum Rate.

Installment Payments. The City may, subject to any rights of prepayment provided in a Supplement, pay to the Authority, solely from Net System Revenues and from no other sources, the Purchase Price in Installment Payments over a period not to exceed the maximum period permitted by law.

The obligation of the City to make the Installment Payments solely from Net System Revenues is absolute and unconditional, and until such time as the Purchase Price has been paid in full (or provision for the payment thereof has been made, the City will not discontinue or

suspend any Installment Payments required to be made by it when due, whether or not the Project or any part thereof is operating or operable or has been completed, or its use is suspended, interfered with, reduced or curtailed or terminated in whole or in part, and such Installment Payments will not be subject to reduction whether by offset or otherwise and will not be conditioned upon the performance or nonperformance by any party of any agreement for any cause whatsoever.

The City agrees and covenants under the Installment Purchase Agreement that all System Revenues will be received by the City in trust and will be deposited when received in the Sewer Revenue Fund. The City agrees and covenants to maintain the Sewer Revenue Fund so long as any Installment Payments or payments due by the City under any Qualified Swap Agreement remain unpaid, and all moneys in the Sewer Revenue Fund will be so held in trust and applied and used solely as provided in the Installment Purchase Agreement.

Selected Covenants of the City

Compliance with Installment Purchase Agreement; Ancillary Agreements. The City will punctually pay Parity Obligations in strict conformity with the terms of the Installment Purchase Agreement and thereof, and will faithfully observe and perform all the agreements, conditions, covenants and terms contained in the Installment Purchase Agreement and will not terminate the Installment Purchase Agreement for any cause including, any acts or circumstances that may constitute failure of consideration, destruction of or damage to the Project, commercial frustration of purpose, any change in the tax or other laws of the United States of America or of the State or any political subdivision of either or any failure of the Authority to observe or perform any agreement, condition, covenant or term contained in the Installment Purchase Agreement or any duty, liability or obligation arising out of or connected therewith or the insolvency, or bankruptcy, or liquidation of the Authority, or any force majeure, including but not limited to, acts of God or acts or regulations of governmental authorities.

The City will faithfully observe and perform all the agreements, conditions, covenants and terms contained in the Installment Purchase Agreement, including Supplements, and any Issuing Instrument or Qualified Swap Agreement relating to Parity Obligations required to be observed and performed by it and each of the agreements, conditions, covenants and terms contained in each such contract and agreement is an essential and material term of the purchase of and payment for each Component by the City pursuant to, in accordance with, and as authorized under the Law.

Against Encumbrances, Sale or Competitive Facilities. The City will not make any pledge of or place any lien on the Net System Revenues except as otherwise provided in the Installment Purchase Agreement. The City will not sell, lease or otherwise dispose of the Wastewater System or any part thereof essential to the proper operation of the Wastewater System or to the maintenance of the System Revenues, except as provided in the Installment Purchase Agreement. The City will not enter into any agreement or lease which impairs the operation of the Wastewater System or any part thereof necessary to secure adequate Net System Revenues for the payment of the Parity Obligations or which would otherwise impair the rights of the Authority with respect to the System Revenues or the operation of the Wastewater System.

Except as permitted under the Installment Purchase Agreement, the City will not, to the extent permitted by existing law, construct, acquire, maintain or operate and will not, to the extent permitted by existing law and within the scope of its powers, permit any other public or private agency, corporation, district or political subdivision or any person whomsoever to acquire, construct, maintain or operate within the City any wastewater system competitive with the City's Wastewater System.

Transfer of Metropolitan System Components. Notwithstanding anything to the contrary in the Installment Purchase Agreement, the City may transfer ownership of substantially all of the Metropolitan System, including amounts in the Sewer Revenue Fund attributable to the Metropolitan System, and any amounts in the Rate Stabilization Fund agreed upon by the City and the transferee as being attributable to the Metropolitan System, to the District or any other governmental agency whose primary purpose is to provide wastewater treatment and disposal service, provided such entity agrees to assume all Obligations the proceeds of which were used to acquire Components which are part of the Metropolitan System and all other obligations relating to the Metropolitan System which are payable from Metropolitan System Revenues, Net Metropolitan System Revenues, System Revenues or Net System Revenues, including but not limited to salaries and benefits payable to employees who are to become employees of such entity, all accounts payable, Qualified Swap Agreements, Credit Provider Reimbursement Obligations and all other obligations with respect thereto such as capital improvement expenditure obligations and tort claims, and the obligation to pay fines, penalties or damages arising out of or relating to violation of federal, state or local laws or regulations which are applicable or purported to be applicable to the operation of the Metropolitan System and provided that the following conditions are met:

(a) there will not have occurred and be continuing an event of default under the terms of the Installment Purchase Agreement, or any other Issuing Instrument or Qualified Swap Agreement or any Termination Event (as defined in a Qualified Swap Agreement) under any Qualified Swap Agreement;

(b) there will have been delivered to the Trustee an opinion of Bond Counsel to the effect that the proposed transfer will not have an adverse effect on the exclusion from gross income for federal income tax purposes of the interest component of Tax-Exempt Installment Payment Obligations;

(c) the entity will have obtained all necessary licenses, permits and consents from all governmental agencies or authorities having or asserting jurisdiction over the activities of Metropolitan System;

(d) there will be delivered to all trustees for any Obligations and to any Qualified Swap Provider an opinion of counsel, who may be the City Attorney of the City, to the effect that the Supplements referred to in clauses (h)(1) and (h)(2) below are valid, binding and enforceable against the transferee in the case of a Supplement referred to in clause (h)(1) below and against the City in the case of a Supplement referred to in a clause (h)(2) below;

(e) the City obtains or provides a certificate prepared by a Consultant showing that (i) the estimated Net Metropolitan System Revenues for the next 12 months following the date of transfer will be at least equal to 1.20 times the Maximum Annual Debt Service for all Outstanding Parity Obligations to be assumed by the transferee, assuming for this purpose that the Outstanding Parity Obligations to be assumed by the transferee will include such Obligations; and (ii) the estimated Net Municipal System Revenues for the next 12 months following the date of transfer will be at least equal to 1.20 times the Maximum Annual Debt Service for all Outstanding Parity Obligations not to be assumed by the transferee, assuming for this purpose that the Outstanding Parity Obligations not to be assumed by the transferee will include all such Obligations;

(f) there will be delivered to the Trustee a notice of each of the Rating Agencies then providing ratings on all Obligations to be outstanding immediately after the transfer, reconfirming the ratings on all such Obligations in effect immediately prior to such transfer, without giving effect to any bond insurance, letter of credit, guarantee or other credit support for such Obligations, or alternatively, all such obligations will be defeased or paid in full prior to such transfer;

(g) there will be delivered to each Owner notice of the intended transfer of Metropolitan System Components not less than 30 nor more than 60 days prior to the expected transfer date; and

(h) incident to a transfer of the Metropolitan System permitted by the Installment Purchase Agreement:

(1) the transferee will execute and deliver to the Trustee a Supplement which will contain the following:

(A) the assumption and indemnification by the transferee of all obligations of the City under the Installment Purchase Agreement, but only as they relate to the Metropolitan System, including Obligations the proceeds of which were used to acquire Components for the Metropolitan System;

(B) a pledge by the transferee of Net Metropolitan System Revenues for the payment of assumed Parity Obligations which will be in substantially the same form as the pledge of the City under the Installment Purchase Agreement of Net System Revenues to secure the payment of all Parity Obligations;

(C) representations of the transferee substantially in the form provided by the City under the Installment Purchase Agreement, but only as to the Obligations assumed by the transferee and the covenants to be contained in such Supplement;

(D) covenants of the transferee relating to the acquisition, construction and changes to the Project, but only as to the Components which are or are to be part of the Metropolitan System;

(E) covenants of the transferee relating to Purchase Payments and Installment Payments, but only as they relate to Parity Obligations being assumed by the transferee and the Net Metropolitan System Revenues;

(F) covenants of the transferee relating to the allocation of System Revenues, but limited only to Parity Obligations assumed by the transferee and moneys deposited from Metropolitan System Revenues and Net Metropolitan System Revenues;

(G) covenants of the transferee relating to Additional Obligations, but only within respect to Parity Obligations payable from Net Metropolitan System Revenues (for this purpose the calculations and coverages contemplated thereby will relate only to Metropolitan System Revenues, Maintenance and Operations Costs of the Metropolitan System and Net Metropolitan System Revenues);

(H) covenants of the transferee substantially in the form provided by the City under the Installment Purchase Agreement, (exclusive of covenants relating to the transfer of the Metropolitan System and subcontracting), but only to the extent of the Metropolitan System and Installment Payment Obligations payable from Metropolitan System Revenues and Net Metropolitan System Revenues and Installment Payment Obligations assumed by or of the transferee.

(I) events of default and remedies substantially in the form set forth in the Installment Purchase Agreement, but only relating to Parity Obligations assumed by the transferee; and

(J) covenants of the transferee relating to benefits of the Installment Purchase Agreement amendments of the Installment Purchase Agreement and the effective date, but only with respect to Parity Obligations assumed by the transferee;

(2) the City will execute and deliver a Supplement which will reaffirm all of the City's representations and warranties under the Installment Purchase Agreement and each Supplement, the pledge provided for in, and each of the covenants of the City contained in the Installment Purchase Agreement or any Supplement, provided that such representations, warranties, pledges and covenants will be limited solely and exclusively to the Municipal System, Municipal System Revenues, Maintenance and Operations Costs of the Municipal System and Net Municipal System Revenues, as the case may be.

Upon execution and delivery of the such Supplements and upon satisfaction of the conditions specified above, the City will be relieved and discharged from any and all Installment Payment Obligations payable from Net System Metropolitan Revenues and which have been assumed by a transferee.

Maintenance and Operation of the Wastewater System; Budgets. The City will maintain and preserve the Wastewater System in good repair and working order at all times and will operate the Wastewater System in an efficient and economical manner and will pay all Maintenance and Operation Costs of the Wastewater System as they become due and payable. The City will adopt and file with the Authority, on or before the effective date of the Installment Purchase Agreement, a budget approved by the City Council of the City setting forth the estimated Maintenance and Operation Costs of the Wastewater System for the period from such date until the close of the then current Fiscal Year. On or before August 1, of each Fiscal Year, the City will adopt, and on or before 120 days after the beginning of the Fiscal Year, file with the Authority a budget approved by the City Council of the City setting forth the estimated Maintenance and Operation Costs of the Wastewater System for such Fiscal Year. Any budget may be amended at any time during any Fiscal Year and such amended budget will be filed by the City with the Authority.

Amount of Rates and Charges; Rate Stabilization Fund. The City will fix, prescribe and collect rates and charges for the Wastewater Service which will be at least sufficient (a) to pay all Obligations, (other than Parity Obligations), and (b) to yield during each Fiscal Year Net System Revenues equal to one hundred twenty percent (120%) of the Debt Service for such Fiscal Year. The City may make adjustments from time to time in such rates and charges and may make such classification thereof as it deems necessary, but shall not reduce the rates and charges then in effect unless the Net System Revenues from such reduced rates and charges will at all times be sufficient to meet the requirements of the Installment Purchase Agreement.

The City may establish, as a fund within the Sewer Revenue Fund, a fund denominated the Rate Stabilization Fund. From time to time the City may deposit into the Rate Stabilization Fund, from current System Revenues, such amounts as the City shall determine and the amount of available current System Revenues shall be reduced by the amount so transferred. Amounts may be transferred from the Rate Stabilization Fund solely and exclusively to pay Maintenance and Operation Costs of the Wastewater System, and any amounts so transferred will be deemed System Revenues when so transferred. All interest or other earnings upon amounts in the Rate Stabilization Fund may be withdrawn therefrom and accounted for as System Revenues.

Insurance. The City will procure and maintain or cause to be procured and maintained insurance on the Wastewater System with responsible insurers, or provide self insurance reserves, in such amounts and against such risks (including accident to or destruction of the Wastewater System) as are usually covered in connection with wastewater systems similar to the Wastewater System. In the event of any damage to or destruction of the Wastewater System caused by the perils covered by such insurance or self insurance, the Net Proceeds thereof will be applied to the reconstruction, repair or replacement of the damaged or destroyed portion of the Wastewater System. The City will pay out of such Net Proceeds all costs and expenses in connection with such reconstruction, repair or replacement so that the same will be completed and the Wastewater System will be free and clear of all claims and liens unless the City

determines that such property or facility is not necessary to the efficient operation of the Wastewater System and therefore determines not to reconstruct, repair or replace such project or facility. If such Net Proceeds exceed the costs of such reconstruction, repair or replacement, then the excess Net Proceeds will be deposited in the Sewer Revenue Fund and be available for other proper uses of funds deposited in the Sewer Revenue Fund.

The City will procure and maintain such other insurance which it will deem advisable or necessary to protect its interests and the interests of the Authority, which insurance will afford protection in such amounts and against such risks as are usually covered in connection with wastewater systems similar to the Wastewater System; provided that any such insurance may be maintained under a self-insurance program so long as such self-insurance is maintained in the amounts and manner usually maintained in connection with wastewater systems similar to the Wastewater System and is, in the opinion of an accredited actuary, actuarially sound.

All policies of insurance required to be maintained in the Installment Purchase Agreement will, to the extent reasonably obtainable, provide that the Authority and the Trustee will be given 30 days' written notice of any intended cancellation thereof or reduction of coverage provided thereby.

Accounting Records, Financial Statements and Other Reports. The City will keep appropriate accounting records in which complete and correct entries will be made of all transactions relating to the Wastewater System, which records will be available for inspection by the Authority and the Trustee at reasonable hours and under reasonable conditions.

The City will prepare and file with the Authority and the Trustee, annually after the close of each Fiscal Year, the following:

- (1) within 270 days financial statements of the Sewer Revenue Fund for the preceding Fiscal Year prepared in accordance with generally accepted accounting principles, together with an Accountant's Report thereon;
- (2) within 45 days, a detailed report as to all insurance policies maintained and self-insurance programs maintained by the City with respect to the Wastewater System as of the close of such Fiscal Year, including the names of the insurers which have issued the policies and the amounts thereof and the property or risks covered thereby; and
- (3) the City will furnish a copy of the financial statements referred to above to any Owner of the Bonds requesting a copy thereof.

Payment of Taxes and Compliance with Governmental Regulations. The City will pay and discharge all taxes, assessments and other governmental charges which may be lawfully imposed upon the Wastewater System or any part thereof or upon the System Revenues when the same will become due. The City will duly observe and conform with all valid regulations and requirements of any governmental authority relative to the operation of the Wastewater System or any part thereof, but the City will not be required to comply with any regulations or requirements so long as the validity or application thereof will be contested in good faith.

Collection of Rates and Charges; No Free Service. The City will have in effect at all times rules and regulations for the payment of bills for Wastewater Services, and that such regulations will provide that where the City furnishes water to the property receiving Wastewater Service, the Wastewater Service charges shall be collected together with the water rates upon the same bill providing for a due date and a delinquency date for each bill. In each case where such bill remains unpaid in whole or in part after it becomes delinquent, the City may disconnect such premises from the water service, and such premises will not thereafter be reconnected to the water service except in accordance with City operating rules and regulations governing such situations of delinquency. The City will not permit any part of the Wastewater System or any facility thereof to be used or taken advantage of free of charge by any corporation, firm or person, or by any public agency (including the United States of America, the State and any city, county, district, political subdivision, public corporation or agency of any thereof).

Eminent Domain Proceeds. If all or any part of the Wastewater System will be taken by eminent domain proceedings, then subject to the provisions of any Authorizing Ordinance, the Net Proceeds thereof will be applied to the replacement of the property or facilities so taken, unless the City determines that such property or facility is not necessary to the efficient operation of the Wastewater System and therefore determines not to replace such property or facilities. Any Net Proceeds of such award not applied to replacement or remaining after such work has been completed will be deposited in the Sewer Revenue Fund and be available for other proper uses of funds deposited in the Sewer Revenue Fund.

Tax Covenants. There shall be included in each Supplement relating to Tax-Exempt Installment Payment Obligations such covenants as are deemed necessary or appropriate by Bond Counsel for the purpose of assuring that interest on such Installment Payment Obligations shall be excluded from gross income under Section 103 of the Code.

Operate Wastewater System. The City will operate the Wastewater System in an efficient and economical manner, provided that the City may remove from the service on a temporary or permanent basis such part or parts of the Wastewater System so long as (a) Net System Revenues are equal to 120% of the Debt Service for the then current Fiscal Year and for each Fiscal Year thereafter to and including the Fiscal Year during which the last Installment Payment is due as evidenced by an engineer's report on file with the City, and (b) the City will have filed with the Trustee an opinion of nationally recognized bond counsel to the effect that the removal of such part or parts of the Wastewater System will not adversely affect the exclusion from gross income for federal income tax purposes of the interest on Tax-Exempt Installment Payment Obligations.

Prepayment of Installment Payments

Provisions may be made in any Supplement for the prepayment of Installment Payments, in whole or in part, in such multiples and in such order of maturity and from funds of any source, and with such prepayment premiums and other terms as are specified in the Supplement. Said Supplement shall also provide for any notices to be given relating to such prepayment.

Events of Default and Remedies of the Authority

The following will be "events of default" under the Installment Purchase Agreement:

- (a) failure in the due and punctual payment of or on account of any Parity Obligation as the same will become due and payable;
- (b) failure by the City in the performance of any of the agreements or covenants required to be performed by it in the Installment Purchase Agreement (other than as specified in (a) above), and such default will have continued for 60 days after the City has been given notice in writing of such default by the Authority;
- (c) if any Event of Default specified in any Supplement, Authorizing Ordinance or Issuing Instrument shall have occurred and be continuing; or
- (d) if the City files a petition or answer seeking arrangement or reorganization under the federal bankruptcy laws or any other applicable law of the United States of America or any state therein, or if a court of competent jurisdiction will approve a petition filed with or without the consent of the City seeking arrangement or reorganization under the federal bankruptcy laws or any other applicable law of the United States of America or any state therein, or if under the provisions of any other law for the relief or aid of debtors any court of competent jurisdiction will assume custody or control of the City or of the whole or any substantial part of its property;

then and in each case during the continuance of such event of default, the Authority shall upon the written request of the Owners of 25 % or more of the aggregate principal amount of all Series of Parity Installment Obligations Outstanding, voting collectively as a single class, by written notice to the City, declare the entire unpaid principal amount thereof and the accrued interest thereon to be due and payable immediately, and upon any such declaration the same shall become immediately due and payable; provided, that with respect to a Series of Parity Installment Obligations which is credit enhanced by Credit Support, acceleration will not be effective unless the declaration is consented to by the related Credit Provider and, provided further, that nothing in the Installment Purchase Agreement shall affect the rights of the parties to a Qualified Swap Agreement to terminate such Qualified Swap Agreement. If at any time after the entire principal amount of all Series of Parity Installment Obligations and the accrued interest thereon have been so declared due and payable and before any judgment or decree for the payment of the moneys due shall have been obtained or entered, the City will deposit with the Authority a sum sufficient to pay the unpaid principal amount of all such Series of Parity Installment Obligations and the unpaid payments of any other Parity Obligations referred to in clause (a) above due prior to such declaration and the accrued interest thereon, with interest on such overdue installments, and the reasonable expenses of the Authority, and any and all other defaults known to the Authority, shall have been made good or cured to the satisfaction of the Authority or provision deemed by the Authority to be adequate shall have been made therefor, then the Authority, by written notice to the City, may rescind and annul such declaration and its consequences.

Discharge of Obligations

If (i) the City will pay or cause to be paid or there will otherwise be paid to the Owners all Outstanding Installment Payment Obligations of a Series the interest thereon and the principal thereof and the redemption premiums, if any, thereon or if all Outstanding Obligations will be deemed to have been paid at the times and in the manner stipulated in the applicable Issuing Instrument, and (ii) the transfer of ownership of substantially all of the Metropolitan System, as contemplated by the Installment Purchase Agreement will have occurred, then all agreements, covenants and other obligations of the City under the Installment Purchase Agreement will thereupon cease, terminate and become void and be discharged and satisfied except for the obligation of the City to pay or cause to be paid all sums due thereunder.

Amendments

The Installment Purchase Agreement may be amended with respect to a Series of Installment Payment Obligations in writing as may be mutually agreed by the City and the Authority, with the written consent of any Credit Provider which is providing insurance until the final maturity or payment in full of one or more maturities of such Installment Payment Obligations, or any other Credit Provider for such Installment Payment Obligations and the Owners of 60% or more in aggregate principal amount of such Installment Payment Obligations then Outstanding, provided that no such amendment will (i) extend the payment date of any Installment Payment, or reduce the amount of any Installment Payment without the prior written consent of the Owner of each Obligation so affect, (ii) reduce the percentage of Installment Payment Obligations the consent of the Owners of which is required for the execution of any amendment of the Installment Purchase Agreement, or (iii) amend the provisions of transfer of the Metropolitan System Components without an unqualified opinion of nationally recognized Bond Counsel to the effect that such amendment does not adversely affect the exclusion of the interest portion of the Installment Payments received by the Owners of Tax-Exempt Installment Payment Obligations from gross income under Section 103 of the Code. Notwithstanding the foregoing, so long as the City has any obligations under a Qualified Swap Agreement, it will not amend or modify, or consent to the amendment or modification of, the Installment Purchase Agreement that would in any way adversely affect (A) the rights of a counterparty to a Qualified Swap Agreement under the Installment Purchase Agreement, or (B) the obligations of the City under the Installment Purchase Agreement to such a contrary without the prior written consent of such Qualified Swap Provider.

With the written consent of any Credit Provider, the Installment Purchase Agreement and the rights and obligations of the City and the Authority thereunder may also be amended, without the written consent of any Owner of Installment Obligations, but only to the extent permitted by law and only upon receipt of an unqualified opinion of nationally recognized Bond Counsel selected by the City and approved by the Authority to the effect that such amendment or supplement is permitted by the provisions of the Installment Purchase Agreement and is not inconsistent therewith and does not adversely affect the exclusion of the interest portion of the Installment Payments received by the Owners from gross income for federal tax purposes, and only (i) to add to the covenants and agreements of the Authority or the City or to surrender any reserved right or power to or conferred upon the Authority or the City, and which will not adversely affect the interests of the Owners of the Installment Payment Obligations; (ii) to cure,

correct or supplement any ambiguous or defective provision, as the Authority or the City may deem necessary or desirable and which will not adversely affect the interests of the Owners of the Installment Payment Obligations; and (iii) to make such other amendments or modifications which will not materially adversely affect the interests of the Owners of the Installment Payment Obligations.

1997-1 Supplement

Tax Exemption. The City will not directly or indirectly use or permit the use of any proceeds of the Component Obligation Series 1997 or any other funds of the City or of the Project or take or omit to take any action that would cause the Component Obligation Series 1997 to be "private activity bonds" within the meaning of Section 141 of the Code, or obligation which are "federally guaranteed" within the meaning of Section 149(b) of the Code.

The City covenants that it will not take any action, or fail to take any action, if such action or failure to take action would adversely affect the exclusion from gross income of the interest represented by the Component Obligation Series 1997 under Section 103 of the Code. The City will not directly or indirectly use or permit the use of any proceeds of the Component Obligation Series 1997 or any other funds of the City, or take or omit to take any action, that would cause the Component Obligation Series 1997 to be "arbitrage bonds" within the meaning of Section 148(a) of the Code. To that end, the City will comply with all requirements of Section 148 of the code to the extent applicable to the Component Obligation Series 1997. In the event that at any time the City is of the opinion that for purposes of this Section it is necessary to restrict or limit the yield on the investment of any moneys held by the Trustee under the Indenture or otherwise, the City shall so instruct the Trustee in writing, and shall cause the Trustee to take such action as may be necessary in accordance with such instructions.

Without limiting the generality of the foregoing, the City agrees that there shall be paid from time to time all amounts required to be rebated to the United States of America pursuant to Section 148(f) of the Code and any temporary, proposed or final Treasury Regulations as may be applicable to the Component Obligation Series 1997 from time to time. This covenant shall survive payment in full or defeasance of the Component Obligation Series 1997. The City specifically covenants to pay or cause to be paid to the United States of America at the times and in the amounts determined under this Section the Rebate Requirement, as described in the Tax Certificate and to otherwise comply with the provisions of the Tax Certificate executed by the City in connection with the execution and delivery of the Component Obligation Series 1997.

Notwithstanding any provision of the 1997-1 Supplement, if the City shall provide to the Trustee an opinion of nationally recognized Bond Counsel to the effect that any action required under the tax covenants contained in the 1997-1 Supplement is no longer required, or to the effect that some further action is required, to maintain the exclusion from gross income of the interest on the Component Obligation Series 1997 pursuant to Section 103 of the Code, the City may rely conclusively on such opinion in complying with the provisions thereof, and the covenants thereunder shall be deemed to be modified to that extent.

Continuing Disclosure. The City will comply with and carry out all of the provisions of the Continuing Disclosure Agreement. Notwithstanding any other provision of the 1997-1

Supplement, failure of the City to comply with the Continuing Disclosure Agreement shall not be considered a default of any kind under the 1997-1 Supplement or the Installment Purchase Agreement; however, the Trustee may (and, at the request of any Participating Underwriter, the Bond Insurer or the Owners of at least twenty-five percent (25%) in aggregate principal amount of Component Obligation Series 1997, shall) or the Bond Insurer or any Owner or Beneficial Owner may take such actions as may be necessary and appropriate, including seeking specific performance by court order, to cause the City to comply with its obligations under the 1997-1 Supplement.

THE CONTINUING DISCLOSURE AGREEMENT

Provision of Annual Reports

The City shall, or shall cause the Dissemination Agent to, not later than 270 days after the end of the City's fiscal year (which fiscal year presently ends June 30), commencing with the report for the 1996-97 fiscal year, provide to each Repository an Annual Report which is consistent with the requirements of the Continuing Disclosure Agreement. In each case, the Annual Report may be submitted as a single document or as separate documents comprising a package, and may cross-reference other information as provided in the Continuing Disclosure Agreement; provided that the audited financial statements of the City may be submitted separately from the balance of the Annual Report and later than the date required above for the filing of the Annual Report if they are not available by that date. If the City's fiscal year changes, it shall give notice of such change in the same manner as for a Listed Event.

Not later than fifteen (15) Business Days prior to the date specified in the Continuing Disclosure Agreement for providing the Annual Report to the Repositories, the City shall provide the Annual Report to the Dissemination Agent (if other than the City or an employee of the City).

If the Dissemination Agent is unable to verify that an Annual Report has been provided to the Repositories by the date required in the Continuing Disclosure Agreement, the Trustee shall send a notice to each Repository and the Municipal Securities Rulemaking Board.

The Dissemination Agent shall:

- (i) determine each year prior to the date for providing the Annual Report the name and address of each National Repository and the State Repository, if any; and
- (ii) file a report with the City (if the Dissemination Agent is not the City), the Authority and (if the Dissemination Agent is not the Trustee) the Trustee certifying that the Annual Report has been provided pursuant to the Continuing Disclosure Agreement, stating the date it was provided, and listing all the Repositories to which it was provided.

Content of Annual Reports

The City's Annual Report shall contain or include by reference the following:

1. The audited financial statements of the City for the prior fiscal year, prepared in accordance with generally accepted accounting principles as promulgated from time to time by the Financial Accounting Standards Board or as otherwise required by applicable State law. If the City's audited financial statements are not available by the time the Annual Report is required to be filed, the Annual Report shall contain unaudited financial statements in a format similar to the financial statements contained in the final Official Statement, and the audited financial statements shall be filed in the same manner as the Annual Report when they become available.
2. An update of the information contained in Table 2 of the Official Statement for the most recently completed fiscal year.
3. An update of the information contained in Table 3 of the Official Statement for the most recently completed fiscal year (exclusive of the information contained under the column heading "Estimated Population").
4. An update of the information contained in Table 4 of the Official Statement for the most recently completed fiscal year.
5. An update of the information contained in Table 5 of the Official Statement for the most recently completed fiscal year.
6. An update of the information contained in Table 6 of the Official Statement for the five most recently completed fiscal years.
7. An update of the information contained in Table 7 of the Official Statement for the most recently completed fiscal year.
8. An update of the information contained in Table 8 of the Official Statement for the five most recently completed fiscal years.
9. An update of the information contained in Table 9 of the Official Statement for the five most recently completed fiscal years.
10. An update of the information contained in Table 10 of the Official Statement for the five most recently completed fiscal years.
11. An update of the information contained in Table 11 of the Official Statement for the five most recently completed fiscal years.
12. Information contained in Table 12 of the Official Statement will be available in the City's audited financial statements.

13. Information contained in Table 13 of the Official Statement will be available in Exhibit D of the City's audited financial statements.

14. Information contained in Table 14 of the Official Statement will be available in Schedules F-1 and F-2 of the City's audited financial statements or it will be presented in tabular form comparable to Table 14.

15. An update of the information contained in the Official Statement under the heading "LABOR RELATIONS" for the most recently completed fiscal year.

16. An update of the information contained in the Official Statement in the third paragraph under the heading "PENSION PLAN" for the most recently completed fiscal year.

17. An update of the information contained in Table 15 of the Official Statement for the five most recently completed fiscal years.

18. An update of the information contained in the Official Statement under the heading "INVESTMENT OF FUNDS - Pool Liquidity and Other Characteristics," " - Derivatives" and " - Reverse Repurchase Agreements" and contained in Table 16 of the Official Statement for the most recently completed fiscal year.

Reporting of Significant Events

The City shall give, or cause to be given, notice of the occurrence of any of the following events with respect to the 1997 Bonds, if material:

1. principal and interest payment delinquencies;
2. non-payment related defaults;
3. modifications to rights of Bondholders;
4. optional, contingent or unscheduled bond calls;
5. defeasances;
6. rating changes;
7. adverse tax opinions or events affecting the tax-exempt status of the 1997 Bonds;
8. unscheduled draws on debt service reserves reflecting financial difficulties.
9. unscheduled draws on credit enhancements reflecting financial difficulties;
10. substitution of credit or liquidity providers, or their failure to perform; and

11. release, substitution or sale of property securing repayment of the 1997 Bonds.

The Dissemination Agent (if other than the City) shall, as soon as reasonably practicable after obtaining actual knowledge of the occurrence of any of the Listed Events, contact the Disclosure Representative, inform such person of the event, and request that the City promptly notify the Dissemination Agent in writing whether or not to report the event pursuant to the Continuing Disclosure Agreement and promptly direct the Dissemination Agent whether or not to report such event to the Bondholders. In the absence of such direction, the Dissemination Agent shall not report such event unless otherwise required to be reported by the Dissemination Agent to the Bondholders under the Indenture. The Dissemination Agent may conclusively rely upon such direction (or lack thereof). For purposes of the Continuing Disclosure Agreement, "actual knowledge" of the occurrence of such Listed Events shall mean actual knowledge by the Dissemination Agent if other than the Trustee, and if the Dissemination Agent is the Trustee, then by the officer at the corporate trust office of the Trustee with regular responsibility for the administration of matters related to the Indenture. The Dissemination Agent shall have no responsibility to determine the materiality of any of the Listed Events.

Whenever the City obtains knowledge of the occurrence of a Listed Event, the City shall as soon as possible determine if such event would be material under applicable federal securities laws.

If the City has determined that knowledge of the occurrence of a Listed Event would be material under applicable federal securities laws, the City shall promptly notify the Dissemination Agent (if other than the City) in writing. Such notice shall instruct the Dissemination Agent to report the occurrence pursuant to the Continuing Disclosure Agreement.

If in response to a request under the Continuing Disclosure Agreement, the City determines that the Listed Event would not be material under applicable federal securities laws, the City shall so notify the Dissemination Agent (if other than the City) in writing and instruct the Dissemination Agent not to report the occurrence.

If the Dissemination Agent is not the City and has been instructed by the City to report the occurrence of a Listed Event, the Dissemination Agent shall file a notice of such occurrence with the Municipal Securities Rulemaking Board and the Repositories with a copy to the City and the Bond Insurer. Notwithstanding the foregoing, notice of optional, contingent or unscheduled bond calls or defeasances need not be given under the Continuing Disclosure Agreement any earlier than the notice (if any) of the underlying event is given to the Owners of affected 1997 Bonds pursuant to the Indenture.

Termination of Reporting Obligation

The City's obligations under the Continuing Disclosure Agreement shall terminate upon the legal defeasance, prior redemption or payment in full of all of the 1997 Bonds. If the City's obligations under the Installment Purchase Agreement are assumed in full by some other entity, such person shall be responsible for compliance with the Continuing Disclosure Agreement in the same manner as if it were the City and the City shall have no further responsibility under

the Continuing Disclosure Agreement. If such termination or substitution occurs prior to the final maturity of the 1997 Bonds, the City shall give notice of such termination or substitution in the same manner as for a Listed Event.

Dissemination Agent

The City may, from time to time, appoint or engage a Dissemination Agent to assist it in carrying out its obligations under the Continuing Disclosure Agreement, and may discharge any such agent, with or without appointing a successor Dissemination Agent. The Dissemination Agent shall not be responsible in any manner for the content of any notice or report prepared by the City pursuant to the Continuing Disclosure Agreement.

Amendment; Waiver

Notwithstanding any other provision of the Continuing Disclosure Agreement, the City and the Trustee may amend the Continuing Disclosure Agreement (and the Trustee shall agree to any amendment so requested by the City; provided, the Trustee shall not be obligated to enter into any such amendment that modifies or increases its duties or obligations thereunder) and any provision of the Continuing Disclosure Agreement may be waived, provided that the following conditions are satisfied:

(a) If the amendment or waiver relates to the provisions concerning the provision and content of Annual Reports or the notice of Listed Events, it may only be made in connection with a change in circumstances that arises from a change in legal requirements, change in law, or change in the identity, nature or status of an obligated person with respect to the 1997 Bonds, or the type of business conducted;

(b) The undertaking, as amended or taking into account such waiver, would, in the opinion of nationally recognized bond counsel, have complied with the requirements of the Rule at the time of the original issuance of the 1997 Bonds, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances; and

(c) The amendment or waiver either (i) is approved by the Owners of the 1997 Bonds in the same manner as provided in the Indenture for amendments to the Indenture with the consent of Owners, or (ii) does not, in the opinion of the Trustee or nationally recognized bond counsel, materially impair the interests of the Owners or Beneficial Owners of the 1997 Bonds.

In the event of any amendment or waiver of a provision of the Continuing Disclosure Agreement, the City shall describe such amendment in the next Annual Report, and shall include, as applicable, a narrative explanation of the reason for the amendment or waiver and its impact on the type (or, in the case of a change of accounting principles, on the presentation) of financial information or operating data being presented by the City. In addition, if the amendment relates to the accounting principles to be followed in preparing financial statements, (i) notice of such change shall be given in the same manner as for a Listed Event, and (ii) the Annual Report for the year in which the change is made should present a comparison (in

narrative form and also, if feasible, in quantitative form) between the financial statements as prepared on the basis of the new accounting principles and those prepared on the basis of the former accounting principles.

Additional Information

Nothing in the Continuing Disclosure Agreement shall be deemed to prevent the City from disseminating any other information, using the means of dissemination set forth in the Continuing Disclosure Agreement or any other means of communication, or including any other information in any Annual Report or notice of occurrence of a Listed Event, in addition to that which is required by the Continuing Disclosure Agreement. If the City chooses to include any information in any Annual Report or notice of occurrence of a Listed Event in addition to that which is specifically required by the Continuing Disclosure Agreement, the City shall have no obligation under the Continuing Disclosure Agreement to update such information or include it in any future Annual Report or notice of occurrence of a Listed Event.

Default

In the event of a failure of the City or the Trustee to comply with any provision of the Continuing Disclosure Agreement, the Trustee may (and, at the request of any Participating Underwriter, the Bond Insurer or the Owners of at least 25% in aggregate principal amount of Outstanding 1997 Bonds, shall), or the Bond Insurer or any Owner or Beneficial Owner of the 1997 Bonds may take such actions as may be necessary and appropriate, including seeking mandate or specific performance by court order, to cause the City or the Trustee, as the case may be, to comply with its obligations under the Continuing Disclosure Agreement. A default under the Continuing Disclosure Agreement shall not be deemed an event of default under the Indenture or the Installment Purchase Agreement, and the sole remedy under the Continuing Disclosure Agreement in the event of any failure of the City or the Trustee to comply with the Continuing Disclosure Agreement shall be an action to compel performance.

Beneficiaries

The Continuing Disclosure Agreement shall inure solely to the benefit of the Authority, the City, the Trustee, the Dissemination Agent, the Participating Underwriters, the Bond Insurer and the Owners and Beneficial Owners from time to time of the 1997 Bonds, and shall create no rights in any other person or entity.

APPENDIX E

FORM OF CO-BOND COUNSEL OPINIONS

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APPENDIX E
FORM OF CO-BOND COUNSEL OPINIONS

Orrick, Herrington & Sutcliffe LLP
777 South Figueroa Street
Suite 3200
Los Angeles, California 90017

Lofton, De Lancie & Nelson
505 Montgomery
Suite 1550
San Francisco, California 94111

March 6, 1997

Public Facilities Financing Authority
of the City of San Diego
202 C Street
San Diego, California 92101

City of San Diego
202 C Street
San Diego, California 92101

Public Facilities Financing Authority
of the City of San Diego
Sewer Revenue Bonds, Series 1997A and Series 1997B
(Payable Solely from Installment Payments
Secured by Wastewater System Net Revenues)
(Final Opinion)

Ladies and Gentlemen:

We have acted as co-bond counsel in connection with the issuance by the Public Facilities Financing Authority of the City of San Diego (the "Authority") of \$250,000,000 aggregate principal amount of its Sewer Revenue Bonds, Series 1997A and Series 1997B (Payable Solely from Installment Payments Secured by Wastewater System Net Revenues) (collectively, the "Bonds"), issued pursuant to an Indenture, dated as of September 1, 1993 (the "Original Indenture"), between the Authority and State Street Bank and Trust Company of California, N.A., as trustee (the "Trustee"), as supplemented by the First Supplemental Indenture, dated as of May 1, 1994 (the "First Supplemental Indenture"), the Second Supplemental Indenture, dated as of December 1, 1995 (the "Second Supplemental Indenture"), and the Third Supplemental Indenture, dated as of February 1, 1997 (the "Third Supplemental Indenture," and together with the Original Indenture, the First Supplemental Indenture and the Second Supplemental Indenture, the "Indenture"), each between the Authority and the Trustee.

Public Facilities Financing Authority
of the City of San Diego
City of San Diego
March 6, 1997

The Bonds are payable from installment payments payable by the City of San Diego (the "City") to the Authority pursuant to a Master Installment Purchase Agreement, dated as of September 1, 1993 (the "Master Installment Purchase Agreement"), between the Authority and the City, as supplemented by the 1993-1 Supplement to the Master Installment Purchase Agreement, dated as of September 1, 1993 (the "1993-1 Supplement"), the 1995-1 Supplement to the Master Installment Purchase Agreement, dated as of December 1, 1995 (the "1995-1 Supplement"), and the 1997-1 Supplement to the Master Installment Purchase Agreement, dated as of February 1, 1997 (the "1997-1 Supplement," and together with the Master Installment Purchase Agreement, the 1993-1 Supplement and the 1995-1 Supplement, the "Installment Purchase Agreement"), each between the City and the Authority, under which the Authority sells to the City portions of a wastewater system. Capitalized terms not otherwise defined herein shall have the meanings set forth in the Indenture and the Installment Purchase Agreement.

In such connection, we have reviewed the Indenture, the Installment Purchase Agreement, the Tax Certificate, dated the date hereof (the "Tax Certificate"), certificates of the City, the Authority, the Trustee and others, opinions of the City Attorney with respect to the Authority and the City, and such other documents, opinions and matters to the extent we deemed necessary to render the opinions set forth herein.

Certain agreements, requirements and procedures contained or referred to in the Indenture, the Installment Purchase Agreement, the Tax Certificate and other relevant documents may be changed and certain actions (including, without limitation, defeasance of the Bonds) may be taken or omitted under the circumstances and subject to the terms and conditions set forth in such documents. No opinion is expressed herein as to any Bond or the interest thereon if any such change occurs or action is taken or omitted upon the advice or approval of counsel other than ourselves.

The opinions expressed herein are based on an analysis of existing laws, regulations, rulings and court decisions and cover certain matters not directly addressed by such authorities. Such opinions may be affected by actions taken or omitted or events occurring after the date hereof. We have not undertaken to determine, or to inform any person, whether any such actions are taken or omitted or events do occur. We disclaim any obligation to update this opinion. We have assumed the genuineness of all documents and signatures presented to us (whether as originals or as copies) and the due and legal execution and delivery thereof by, and validity against, any parties other than the Authority and the City. We have not undertaken to verify independently, and have assumed, the accuracy of the factual matters represented, warranted or certified in the documents, and of the legal conclusions contained in the opinions, referred to in the second paragraph hereof. Furthermore, we have assumed compliance with all covenants and agreements contained in the Indenture, the Installment Purchase Agreement and the Tax Certificate, including without limitation covenants and agreements compliance with

Public Facilities Financing Authority
of the City of San Diego
City of San Diego
March 6, 1997

which is necessary to assure that future actions, omissions or events will not cause interest on the Bonds to be included in gross income for federal income tax purposes. We call attention to the fact that the rights and obligations under the Bonds, the Indenture, the Installment Purchase Agreement and the Tax Certificate may be subject to bankruptcy, insolvency, reorganization, arrangement, fraudulent conveyance, moratorium and other laws relating to or affecting creditors' rights, to the application of equitable principles, to the exercise of judicial discretion in appropriate cases and to the limitations on legal remedies against public entities in the State of California. We express no opinion with respect to any indemnification, contribution, choice of law, choice of forum or waiver provisions contained in the foregoing documents. Finally, we undertake no responsibility for the accuracy, completeness or fairness of the Official Statement or other offering material related to the Bonds and express no opinion with respect thereto.

Based on and subject to the foregoing, and in reliance thereon, as of the date hereof, we are of the following opinions:

1. The Bonds constitute the valid and binding limited obligations of the Authority.
2. The Bonds are special obligations of the Authority and are payable solely from Revenues (as such term is defined in the Indenture), which Revenues include Installment Payments pursuant to the Installment Purchase Agreement.
3. The Indenture and the Installment Purchase Agreement have been duly executed and delivered by, and constitute the valid and binding obligations of, the Authority. The Indenture creates a valid pledge, to secure the payment of the principal of and interest on the Bonds, of the Revenues and any other amounts (including proceeds of the sale of the Bonds) held by the Trustee in any fund or account established pursuant to the Indenture, except the Rebate Fund, subject to the provisions of the Indenture permitting the application thereof for other purposes and on the terms and conditions set forth therein.
4. The Installment Purchase Agreement has been duly executed and delivered by, and constitutes the valid and binding obligation of, the City. The Installment Purchase Agreement creates a valid pledge of Net System Revenues to secure the payment of Installment Payments to the Authority, on the terms and conditions set forth therein.
5. Interest on the Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986 and is exempt from California personal income taxes. To the extent the initial offering price to the public (excluding bond houses and brokers) at which a substantial amount of the Bonds is sold is less than the

Public Facilities Financing Authority
of the City of San Diego
City of San Diego
March 6, 1997

amount payable at the maturity thereof, the difference constitutes "original issue discount" for purposes of federal income taxes and State of California personal income taxes. Original issue discount is treated as interest that is excluded from gross income for federal income tax purposes and is exempt from California personal income taxes to the extent properly allocable to each owner thereof. Interest (including original issue discount) on the Bonds is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, although we observe that interest (including original issue discount) on the Bonds is included in adjusted current earnings when calculating corporate alternative minimum taxable income. We express no opinion regarding other tax consequences related to the ownership or disposition of, or the accrual or receipt of interest on, the Bonds.

Faithfully yours,

Respectfully submitted,

ORRICK, HERRINGTON & SUTCLIFFE LLP

LOFTON, DE LANCIE & NELSON

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APPENDIX F

SPECIMEN MUNICIPAL BOND INSURANCE POLICY

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Financial Guaranty Insurance
Company
115 Broadway
New York, NY 10006
212 312-3000
800 352-0001

A GE Capital Company



Municipal Bond New Issue Insurance Policy

Issuer:

Policy Number:

Control Number:

Bonds:

Premium:

Financial Guaranty Insurance Company "Financial Guaranty", a New York stock insurance company, in consideration of the payment of the premium and subject to the terms of this Policy, hereby unconditionally and irrevocably agrees to pay to State Street Bank and Trust Company, N.A., or its successor, as its agent, the "Fiscal Agent", for the benefit of Bondholders, that portion of the principal and interest on the above-described debt obligations (the "Bonds") which shall become Due for Payment but shall be unpaid by reason of Nonpayment by the Issuer.

Financial Guaranty will make such payments to the Fiscal Agent on the date such principal or interest becomes Due for Payment or on the Business Day next following the day on which Financial Guaranty shall have received Notice of Nonpayment, whichever is later. The Fiscal Agent will disburse to the Bondholder the face amount of principal and interest which is then Due for Payment but is unpaid by reason of Nonpayment by the Issuer but only upon receipt by the Fiscal Agent, in form reasonably satisfactory to it, of (i) evidence of the Bondholder's right to receive payment of the principal or interest Due for Payment and (ii) evidence, including any appropriate instruments of assignment, that all of the Bondholder's rights to payment of such principal or interest Due for Payment shall thereupon vest in Financial Guaranty. Upon such disbursement, Financial Guaranty shall become the owner of the Bond, appurtenant coupon or right to payment of principal or interest on such Bond and shall be fully subrogated to all of the Bondholder's rights thereunder, including the Bondholder's right to payment thereof.

This Policy is non-cancellable for any reason. The premium on this Policy is not refundable for any reason, including the payment of the Bonds prior to their maturity. This Policy does not insure against loss of any prepayment premium which may at any time be payable with respect to any Bond.

As used herein, the term "Bondholder" means, as to a particular Bond, the person other than the Issuer who, at the time of Nonpayment, is entitled under the terms of such Bond to payment thereof. "Due for Payment" means, when referring to the principal of a Bond, the stated maturity date thereof or the date on which the same shall have been duly called for mandatory sinking fund redemption and does not refer to any earlier date on which payment is due by reason of call for redemption (other than by mandatory sinking fund redemption), acceleration or other advancement of maturity and means, when referring to interest on a

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Municipal Bond New Issue Insurance Policy

Bond, the stated date for payment of interest. "Nonpayment" in respect of a Bond means the failure of the Issuer to have provided sufficient funds to the paying agent for payment in full of all principal and interest Due for Payment on such Bond. "Notice" means telephonic or telegraphic notice, subsequently confirmed in writing, or written notice by registered or certified mail, from a Bondholder or a paying agent for the Bonds to Financial Guaranty. "Business Day" means any day other than a Saturday, Sunday or a day on which the Fiscal Agent is authorized by law to remain closed.

In Witness Whereof, Financial Guaranty has caused this Policy to be affixed with its corporate seal and to be signed by its duly authorized officer in facsimile to become effective and binding upon Financial Guaranty by virtue of the countersignature of its duly authorized representative.

A handwritten signature in black ink, appearing to be "A. L. H.", written over a large, diagonal "SUPPLEMENTAL" watermark.

President

Effective Date:

Authorized Representative

State Street Bank and Trust Company, N.A., acknowledges that it has agreed to perform the duties of Fiscal Agent under this Policy.

A handwritten signature in black ink, appearing to be "D. J. M.", written over a large, diagonal "SUPPLEMENTAL" watermark.

Authorized Officer

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Endorsement To Financial Guaranty Insurance Company Insurance Policy

Policy Number:

Control Number:

It is further understood that the term "Nonpayment" in respect of a Bond includes any payment of principal or interest made to a Bondholder by or on behalf of the issuer of such Bond which has been recovered from such Bondholder pursuant to the United States Bankruptcy Code by a trustee in bankruptcy in accordance with a final, nonappealable order of a court having competent jurisdiction.

NOTHING HEREIN SHALL BE CONSTRUED TO WAIVE, ALTER, REDUCE OR AMEND COVERAGE IN ANY OTHER SECTION OF THE POLICY. IF FOUND CONTRARY TO THE POLICY LANGUAGE, THE TERMS OF THIS ENDORSEMENT SUPERSEDE THE POLICY LANGUAGE.

In Witness Whereof, Financial Guaranty has caused this Endorsement to be affixed with its corporate seal and to be signed by its duly authorized officer in facsimile to become effective and binding upon Financial Guaranty by virtue of the countersignature of its duly authorized representative.

President

Effective Date:

Authorized Representative

Acknowledged as of the Effective Date written above:

Authorized Officer

State Street Bank and Trust Company, N.A., as Fiscal Agent

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